DEVELOPING ALTERNATIVES

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GROUNDS FOR GROWTH

Enhancing the Competitiveness Impacts of Business Environment Reform

DAI

Since 1970, DAI has explored alternative paths to development. DAI generates ideas through research, shares these ideas with the development community through publications, and tests the ideas in the crucible of development projects.

Developing Alternatives provides a forum for DAI's professional staff and collaborators to expose their ideas to a wider audience. Articles treat issues of topical interest and aim at promoting broad discussion.

Guest Editor: Ulrich F.W. Ernst
Series Editor: Steven O'Connor
Copy Editor: Peg Hausman
Designer: Joanne Kent

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DAI Washington, 7600 Wisconsin Avenue, Suite 200, Bethesda, MD 20814 USA
Tel: +1 301 771 7600 www.dai.com

DAI Europe, Suite 440, Southbank House, Black Prince Road, London SE1 7SJ, United Kingdom
Tel: +44 (0) 207 420 8600 www.dai-europe.com

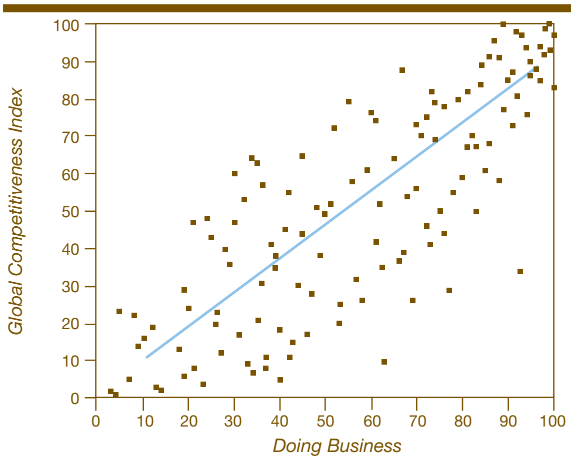
BEYOND REGULATORY REFORM

by Ulrich F.W. Ernst

Where's the (competitiveness) beef?

Doing Business in 2009, the latest edition of the World Bank/International Finance Corporation's annual international comparison, proudly announces "Five years of reform." In fact, that claim gives short shrift to the regulatory reform initiatives that predate the *Doing Business* series, a history of reform efforts that spans the world. After all, Sweden launched its "regulatory guillotine" program in the 1980s; Mexico used its accession to the General Agreement on Tariffs and Trade, the Organisation for Economic Co-operation and Development (OECD), and the North American Free Trade Agreement to revamp its regulatory regime in the 1990s; and many other countries—Korea in the wake of the financial crisis in the late 1990s, the Netherlands, Norway, and other OECD members—pursued their own reform initiatives. In the United States, Circular A-76, issued by the Office of Management and Budget in 1983, imposed mandatory regulatory impact analysis.

FIGURE 1. GLOBAL COMPETITIVENESS AND THE EASE OF DOING BUSINESS



That said, publication of the *Doing Business* assessments has focused attention on regulatory (and administrative) reform. It has also prompted some deliberate efforts to pursue reforms—as measured by the *Doing Business* indicators—more aggressively: last year, for example, Azerbaijan vaulted over more than a third of the countries ranked by *Doing Business*, moving from rank 97 to 33—a breathtaking leap.

Does the investment of time and effort in regulatory reform lead to measurable gains in economic growth and welfare? There is a strong theoretical case for lightening the regulatory burden to improve competitiveness. Facing a lower regulatory "overhead," companies should gain price competitiveness. A better, more supportive regulatory regime—"smart regulation"—should help firms in their quest to deliver a better product or service. But showing that relationship quantitatively has proved somewhat elusive. Several studies at the *macro* level, linking some aggregate measure of "regulatory quality" to measures of economic performance, have found a statistical association between the two sets of variables. The graph on the left shows that pattern, linking rankings on the *Doing Business* indicators and the largely self-assessed national competitiveness rankings using the World Economic Forum's *Global Competitiveness Index* (data are taken from the latest rankings, *Doing Business in 2009* and the *Global Competitiveness Report 2008–2009)*. The graph shows a fairly strong relationship among the leaders as well as the laggards—both the upper right and the lower left of the graph—but it is difficult to discern much of a pattern in the middle ranges.[1] (The outlier

[1] To show the patterns, the rankings on both the "Ease of doing business indicators" from the *Doing Business* rankings and the *Global Competitiveness Index* were inverted and standardized, so that the best performer achieves a score of 100 in both measures, and the worst performers are in the lower left of the graph. The regression line is defined by: GCI = 2.00 + 849 * DB (with an r-square of 0.657).

in the right-hand side of the graph, with a high *Doing Business* score and a low competitiveness ranking, is Georgia, the reform champion for 2006–2007.)

However, it has turned out to be more difficult to "prove" that the causality runs from improvements in the regulatory environment to growth. Perhaps better-performing economies can afford to spend more on regulatory reform? Some studies have tried to demonstrate that the causality runs from the regulatory regime to growth, but their statistical techniques leave room for doubt. One conclusion is that perhaps macro-level associations are not the way to demonstrate impact empirically.

Part of the problem, of course, is that what matters in theory may not matter in practice. Small and medium-sized enterprises in Italy have been highly competitive in world markets despite a regulatory environment that would probably choke entrepreneurial spirit elsewhere. There are cases where on-the-ground regulatory reforms fail to be reflected in international comparison indicators. And cases abound where shifts in some indicators have changed little on the ground. What is needed is a reality check that traces the effects of regulatory reforms at the micro level: how do microeconomic indicators of competitiveness—productivity, market performance, and so on—react to changes in the regulatory regime?

Looking at regulatory reform through the competitiveness lens

Seeking to understand the impact of regulatory reform on competitiveness, some researchers have adopted a sectoral point of view. Looking at the competitiveness impacts of the regulatory regime, writ large, from the perspective of an individual value chain makes it easier to evaluate possible reforms in quantitative terms. Quantitative measures of the effects of proposed reforms in turn make it easier to prioritize proposed reforms and to generate support from the value chain stakeholders.

Virtually any sound analysis of the competitive performance of a value chain already includes an assessment of the business environment's impact on cost structure and innovation options. But there are now a number of efforts to deepen that analysis as a way to define and promote priorities for reform. For the U.S. Agency for International Development's Office of Microenterprise Development, DAI has developed an approach called CIBER (Competitiveness Impacts of Business Environment Reform), which involves three phases: identifying constraints or gaps in the business environment that affect competitiveness at different stages of the value chain, appraising the magnitude of these competitiveness impacts, and developing a strategy to promote high-priority reforms. The first and third phases require highly collaborative interaction with value chain stakeholders. The second may involve direct participation of the value chain participants, but it is more analytical, stressing the quantitative estimation of price or nonprice impacts on competitiveness.

Price impacts are shaped by the direct and indirect costs imposed by demands of the business environment. The impact of reforms to reduce or eliminate these demands can then be translated into cost savings. The impact of reforms to improve the nonprice impacts on competitiveness—impacts caused by the lack of enforcement of quality standards, for example, or by unfair competition—may require further analysis. Bryanna Millis's and Dan Charette's article describes the CIBER approach in detail and provides several examples of its application.

Taxation is central to the interaction between business and the state. The *Doing Business* series includes "Paying Taxes" among its 10 indicators, but this indicator combines the burden imposed by tax administration requirements (number of payments, time required) with the burden imposed by the tax regime proper (tax as a percentage of profit). The World Bank's internal evaluation group has criticized this approach, and has suggested that the "Paying Taxes" indicator focus exclusively on tax administration. The paper by Mark Gallagher and Arturo Jacobs in this issue examines options for reducing the tax compliance costs for business in some detail; the points they raise may serve as a blueprint for redefining the relevant indicator.

Talking the talk or walking the walk?

Tracing the effects of the business environment on competitiveness is critical to the articulation of reform priorities, and to the design and implementation of actual reform strategies. Successful regulatory reform drives have involved an effective dialogue between the public and the private sector. But they have also involved a dialectic between the demand for reform, the exploration (and implementation) of new solutions, and the design of a comprehensive program at the level of the national economy. In many instances, the impetus for reform has come from below. Municipalities or local administrations see an opportunity for streamlining operations, and implement them within the existing regulatory framework. As they demonstrate that progress is possible, pressure builds to implement the reforms nationwide. One example: DAI's BIZPRO Project in Moldova spawned and supported the establishment of one-stop shops to speed up the process of obtaining construction permits or trade authorizations. Some of these one-stop shops worked, others never got off the ground, because compliance by the agencies involved was voluntary. The legal framework for authorizing and enforcing this option was lacking. With proper support, the bottom-up initiatives in one-stop shops can promote "top-down" responses to establish the proper legal framework.

There is a long-standing discussion of the relationship between bottom-up and top-down reform. The spring 2006 issue of DAI's *Developing Alternatives* publication, *Breaking the Rules That Bind*, offered a spirited debate on this topic. Experiences in Ukraine and Vietnam suggested that much of the driving force behind regulatory reform may come from local administrations (oblasts and provinces), which then filters up through the political process to trigger reforms from the top down. But the comprehensive review and "weeding" of the regulatory regime in Moldova was an initiative by the central government—a case that mirrors the national-level reform in many OECD countries. Moldova thus illustrates the benefits of both the bottom-up (one-stop shops) and top-down (regulatory guillotine) strategies.

How successful regulatory drives proceed may therefore depend on the situation. However, there is a growing interest among regulatory reformers in stimulating competition at the level of local administrations. In fact, a number of the indicators of the *Doing Business* type focus less on regulations per se than the administrative practices that determine how many steps are required, how long they take, and what their cost might be. In Vietnam and Morocco, DAI has used the power of competition to drive administrative streamlining at the local level and promote corresponding changes at the national level. Given the success of these efforts, there is now a growing emphasis on promoting reform competition among subnational (regional or local) units as a means of changing the business environment.

Since then, we have refined tools such as the Provincial Competitiveness Index in Vietnam—or the adaptation of the *Doing Business* approach at a regional (subnational) level—to inventory bottom-up reforms and use that information to support top-down reforms. The papers by Lara Goldmark and by Helle Weeke, Steve Parker, and Edmund Malesky explore our experiences in Morocco and Vietnam. Looking at the variations in the business environment within a common regulatory framework offers insights into reforms that do not necessarily depend on extensive legislative action to achieve results. And the success of such reforms in turn can guide the legislative agenda. The paper on Vietnam also shows the two strands of national-level reforms—driven by both trade treaties and reaction to provincial-level initiatives.

As always, one size may not fit all. A basic element in bottom-up competition is the publication of metrics that measure the regulatory (including administrative) performance of local units. But open advocacy and public comparisons and measurements may not always be the best strategy. Sometimes it is better to walk the walk, implementing regulatory reforms in a gradual way, rather than loudly talk the talk, which may convince some, but may also incite opposition. Contrasting his recent experiences in Egypt with the cases of Ukraine and Moldova (where there was a very public outreach effort—billboards on the road to the airport exhorted small business owners to "fight back" against corruption), Denis Gallagher's article makes a convincing case for the "stealth" approach that achieves reforms without much public advocacy.

Regulatory transparency

The demand for more transparency in the regulatory process by which the executive interprets legislative intent is growing as economies become more and more interdependent. The watchword here is *regulatory transparency*, which may range from opening up the process of rulemaking to allow for vetting of proposed regulations by business and civil society, to very specific arrangements that ensure domestic technical standards are developed with the input of major trading partners and accessible to all. The World Trade Organization imposes minimum standards on its members, but the growing importance of bilateral free trade agreements often imposes even stricter standards that require specific efforts by the trading partners, depending on their current provisions.

Two contributors to this issue explore the path to regulatory transparency. Jeffrey Lubbers reviews recent developments in rulemaking in the United States, while Delia Rodrigo summarizes trends in other OECD countries, as well as in developing economies.

Finding the right balance

We have moved beyond the notion that better regulation is simply less regulation. As Robert Klitgaard noted in *Adjusting to Reality: Beyond "State Versus Market" in Economic Development*, "neither the interventionist state nor the minimalist state has guaranteed rapid development" (Klitgaard 1991, 4–5). In response, most regulatory reform efforts are now sailing under the flag of "smart regulation" or "better regulation," rather than the more radical notions of the "regulatory bulldozer" or the "regulatory guillotine."

The articles in this volume are therefore better seen as snapshots of an evolving field, rather than a definitive statement of a mature field. We do not have all the answers, but we are closer to targeting regulatory reform to support economic dynamism and market responsiveness, without sacrificing human concerns in terms of health, safety, and the environment. One salient lesson is that successful and lasting reforms demand effective public-private dialogue. We have new tools at our disposal, and advances in information technology make it much easier to encourage transparency and participation in the rulemaking process, but the struggle to find the right balance continues.

Reference

Klitgaard, Robert. 1991. *Adjusting to Reality: Beyond "State versus Market" in Economic Development*. San Francisco: ICS Press and International Center for Economic Growth.

COMPETITIVENESS IMPACTS OF BUSINESS ENVIRONMENT REFORM: A BOTTOM-UP APPROACH

by Bryanna Millis and Dan Charette

The business environment shapes competitiveness

Governments at all levels are responsible for creating the business environment that can boost the competitiveness of the economy—or sap it. Actions by the legislative, executive, and judicial branches of government can impose costs, such as financial costs or costs in terms of time, aggravation, and risk, but government oversight is also required to ensure the smooth functioning of the market. High transaction costs caused by expensive, time-consuming, and complex regulations are linked to high levels of economic informality, high rates of unemployment or underemployment, lack of investment, and the inability of enterprises to compete with imports or, more broadly, with competitors in the global market. Meanwhile, lack of meaningful regulations and enforcement of quality standards often exclude businesses from key markets and may lead to "immiserizing growth" as enterprises are forced to compete on cost alone.

The quest to create a business *enabling* environment, one that favors competitive performance, is nothing less than the search for the proper balance between state and market. Governments in Organisation for Economic Co-operation and Development countries and elsewhere are pursuing regulatory (and administrative) reforms to make it easier to "do business." Such reforms have become a focal point in development programming over the past decade as several factors have converged. Multilateral and bilateral donors began to categorize and track the competitiveness impacts of the business environment through publications such as the World Economic Forum's *Global Competitiveness Report*, the World Bank's *Doing Business* series, and more specialized rankings such as those prepared by Transparency International. International comparisons draw governments into a cross-border discussion of regulatory reform, with the resulting rankings giving cause for national pride or shame (or feigned indifference). They even create a sense of inter-country competition that has itself been credited with driving some reforms.

Meanwhile, international integration has heightened the stakes for countries to reduce regulatory burdens. The "carrots" of membership in the World Trade Organization or the European Union (EU), or the prospect of free trade agreements, may require significant revisions to national legal and regulatory codes, both to bring them into compliance with new rules and to improve the countries' ability to benefit from new opportunities. A wave of donor-funded economic growth programs assisting countries to improve the national laws on the books—"top-down" regulatory reform—has emerged to support these changes, using tools such as regulatory impact analysis, competitiveness partnerships, and the regulatory guillotine, as well as direct support for rewriting laws and regulations. Yet these top-down approaches should be complemented by "bottom-up" approaches that assess priorities for regulatory change demanded by business, and that involve the public servants charged with implementing the reforms.

Among bottom-up initiatives that focus on the enterprise and local government levels, the value chain framework for analyzing and reforming the business environment is emerging as an innovative way to strengthen the realism, relevance, and sustainability of regulatory reform. This framework identifies the priorities of specific constituencies, increasing the flexibility projects have to address constraints at various levels of government and generate impact as project resources and political opportunities allow. Furthermore, as the U.S. Agency for International Development (USAID) Office of Microenterprise Development recognizes, addressing targeted issues through a gradual approach—one that mitigates political risk and provides opportunities for demonstration effects—is a good way to overcome resistance to reform. Finally, responding to the priorities of value chain stakeholders encourages private sector vigilance over the reform process, and this ownership makes reform more sustainable.

The tool: CIBER

The Competitiveness Impacts of Business Environment Reform (CIBER) approach is a pragmatic, participatory, and action-oriented set of guidelines for policy innovation. CIBER systematically identifies priorities in business environment reforms. It involves estimating the cost and quality impacts of burdensome regulations or areas where a lack of regulations impedes competitiveness; reviewing the political and administrative feasibility of reforms; and developing (and implementing) advocacy plans to support reform initiatives. CIBER stresses developing and strengthening networks of stakeholders who are deeply engaged in the process and ultimately lead and maintain advocacy initiatives.

CIBER views competitiveness in terms of productivity at each stage of the value chain, measured as the ratio of the value added to the cost of all inputs—that is, total factor productivity.[1] Against that background, it focuses on quantifiable contributions of business environment reforms on aggregate productivity in the value chain. In a value network environment, where productivity gains often depend on the ability to "jump" to a new technology, product, or market, the CIBER approach provides a systematic method to quantify the ways in which the business environment affects prospects for raising competitiveness. It then complements the exploration of potential reform benefits by examining the costs and risks of proposed reforms for private and public sector stakeholders, primarily in terms of the political and administrative feasibility of implementing the reforms. Using this information, researchers and project staff—and their counterparts in the respective value chains—are empowered to develop strategies for advocacy and effective business environment reform.

CIBER was first developed and applied in a study of the Brazilian cashew nut value chain and subsequently used in the Serbian nontimber forest products (mushroom) and Ethiopian handloom weaving value chains, among others. These applications illustrate CIBER's flexibility in conducting assessments at various levels of detail, depending on the need for information and the resources available. In Brazil, in-depth analyses were conducted on a number of regulatory constraints; in Serbia and Ethiopia, CIBER supported rapid appraisals of business environment constraints to feed into program design. The strengths of this method are its intensive and continuing involvement of stakeholders to identify the issues that matter most and contribute most to the development and implementation of reform advocacy initiatives.

Identifying reform priorities for cashew nuts in Ceará, Brazil[2]

Background

The cashew industry generates significant employment and export revenues for the poor northeastern region of Brazil, specifically the state of Ceará. Monetary and tax incentives initially drove the development of this industry in the 1960s; over subsequent decades, Brazil became a leading producer, processor, and exporter of cashew nuts. However, between the mid-1990s

[1] Both the value added at each stage and the resource cost should be measured in a way that accounts for policy-induced price distortions. While total factor productivity is generally not easy to measure, it remains the conceptual benchmark for assessing competitiveness gains (or losses).

[2] Full case study prepared by Hugo Figueirêdo Júnior.

and mid-2000s, the world supply of cashew nuts nearly tripled as a result of improved productivity in India, Vietnam, and several African nations. Increased global competition sparked the need for the Brazilian cashew industry to reassess existing policies and determine how best to maintain and improve competitiveness.

India, Vietnam, and Mozambique (representing African nations that have begun to revive their cashew industries) have maintained much lower labor costs and have experienced stable exchange rates in recent years. Furthermore, in India and Vietnam the more productive dwarf tree variety is prevalent. Meanwhile, in Brazil, high labor costs have forced increased mechanization of processing, resulting in 45 to 50 percent broken kernels, which are of lower value in the world market (the semi-mechanized processing used elsewhere has a 25 to 30 percent breakage rate). Further harming Brazil's competitiveness are the exchange rate appreciation of the Brazilian currency against the dollar and the continuing reliance of Brazilian producers on the less productive giant tree variety.

Identifying constraints

Discussions with industry experts, including representatives from the Cashew Extension Services (EMBRAPA), helped the CIBER research team identify a short list of constraints. Through in-depth meetings with value chain stakeholders—small and large producers and processors, the state tax collector, an export broker, and traders—the team analyzed each of these constraints to confirm its importance.

This review process eliminated some constraints from consideration due to their minimal impact on competitiveness or lack of stakeholder interest in pursuing reform. These discarded constraints included a proposed policy to classify cashew nuts by quality grade; while this item may ultimately increase the price value chain actors are able to obtain, industry stakeholders perceived a high level of risk in making this change. Five constraints were ultimately retained for further analysis:

1) tax credit refund delays at the state level (ICMS);
2) tax credit refund delays at the national level (PIS/COFINS);
3) the State of Piauí's artificial price reference for ICMS charges;
4) limitations on microcredit working capital; and
5) labor regulations.

The CIBER analysis relied on cost-price models for cashew production and processing to assess the impact of different constraints on price competitiveness. Price competitiveness in turn establishes incentives for management innovation.

Tax credit refund delays at the state and national level

The first three issues listed above can be examined jointly. Tax credit refund delays and losses caused by the ICMS and PIS/COFINS regulations (originally created to promote exports) increase the cost of cashew nut kernels purchased by processors by more than 5 percent. For a 50-pound box sold at US$104 in 2007, that translates into a $7 increase, potentially more than half of the processor's margin. Furthermore, because exports are tax exempt, the more the processor exports, the less it can use its tax credits and the more it suffers from having to absorb the tax credit losses. Thus, tax credit issues effectively penalize cashew nut exporters.

Microcredit working capital limitations

Approximately 25 percent of producers sell their production to intermediaries four months before the harvest season at huge price discounts in exchange for working capital advances. These advances amount to approximately 50 percent of sales, with the rest being paid upon cashew nut delivery during harvest season (DAI 2006). The existing formal credit program (PRONAF, the National Family Agriculture Program) does not provide enough credit to meet demand. In 2007, for example, fewer than 3 percent of cashew producers in Ceará had access to credit from this source.

Banco do Nordeste is managing Agroamigo, an innovative microcredit system launched in 2005 using PRONAF funds. However, eligibility restrictions have limited the program to roughly 15 percent of cashew producers. Furthermore, the credit provided under Agroamigo has thus far been limited to capital expenditures, while the bulk of demand is for working capital before the harvest season. Two changes are needed: to broaden eligibility for Agroamigo loans, and to allow lending for the much-needed working capital. If more flexible Agroamigo loans allow producers to avoid expensive trade finance—the huge price discounts for selling the production four months before the harvest to obtain working capital—the benefits could be as high as 40 percent of the total cashew price.

Government banks have the funds to support these changes, but interest rates may have to be adjusted to offer a credit product that both offers profit to them and serves the right customers. A feasible solution could be a commercial credit line with 1.5 percent interest a month. While more expensive than PRONAF's 1.5 percent a year, it would be much less costly than the 30 percent a month currently charged by intermediaries.

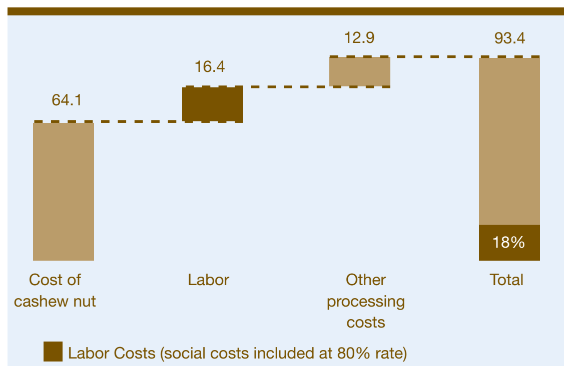
Labor costs

With respect to labor regulations, the analysis sought to understand labor's impact on competitiveness, but advocacy for change in this area was considered to be out of the scope of one specific business activity. The high cost of labor in Brazil is partially related to the minimum wage and exchange rate policies pursued by the national government, particularly in the past five years. However, a considerable portion of the labor cost results from social costs that employers are required to pay. Labor costs for cashew producers represent 70 to 80 percent of total costs (depending on the variety of tree grown) before the additional cost of the social benefits are included.

If social costs are included at the rate of close to 60 percent of the salaries for rural activities, as specified by current regulations, the existing narrow profit margin quickly turns into a loss. For this reason, many producers do not comply with the regulation and take the risk of judicial disputes or, in order to comply, reduce labor costs by leaving trees without the adequate care (at the expense of productivity). The government does not enforce the regulations industry-wide but usually selects large producers for enforcement visits—as a result, cashew production in Brazil is increasingly dominated by small producers and family-run operations.

At the *processing* step of the value chain, total processing costs are estimated at $93 per 50-pound box of cashew nut kernels (which sold for $104 in 2007) for a typical mechanized facility, which accounts for 98 percent of the cashew nuts processed in Brazil. Labor costs—including social costs at the rate of approximately 80 percent of salaries for urban industrial activities, as specified by the current regulations—represent close to 18 percent of the total production costs, the second most important cost after raw material (see Figure 1). Since all the mechanized processors are large companies, regulation enforcement is rigid, which encourages firms to continue automating as much

FIGURE 1: LABOR COST AS A PROPORTION OF TOTAL COSTS OF CASHEW NUT PROCESSING



Mechanized Process, December 2007 (US$/box of cashew nut kernel);
Source: Hugo Figueirêdo Junior, authors' analysis

of the process as they can. For labor-intensive activities that are difficult to automate, some large processors outsource to labor cooperatives, which are subject to lower social costs.

Assessing the political and administrative feasibility of specific reforms

Once the constraints and gaps in the targeted value chain have been analyzed to establish the priorities for enhancing competitiveness, CIBER evaluates the feasibility of each proposed reform according to the following criteria: well-defined demand, few political or administrative constraints, a clearly identified natural champion within the industry (to spark debate and ensure follow-up), accessible advocacy measures, and the likelihood of creating more winners than losers.

Table 1 summarizes the results of the feasibility appraisal for the five regulations described above.

As expected, labor regulation reforms do not pass the feasibility test. However, tax regulations have very well defined demand: the goal is to allow cashew nut exporters to obtain prompt refunds from their tax credits. Since tax laws are usually written for specific business activities, reforms advocated by a natural champion at either the local or national level will make the flow of negotiations easier. The geographic concentration of the industry in Ceará State amplifies the arguments of a reform champion, enabling a targeted advocacy approach. With respect to the ICMS regulation specific to Piauí, a natural champion is harder to find because reforms would affect different parts of the value chain differently.

Finally, the working capital credit expansion reform is clearly defined, with a large number of beneficiaries—namely, small producers. However, these producers are not cohesively represented, which may reduce the effectiveness of the advocacy (a possible champion to unite the produc-

TABLE 1: BRAZIL CASHEW VALUE CHAIN: ADVOCACY FEASIBILITY MATRIX

Regulatory Constraint	Reform Demanded	Feasibility Aspect				
		Advocacy Level	Natural Champion	Winners	Losers	Constraints
State ICMS (VAT) tax refund delay to exporters	Prompt refund of all ICMS credits to cashew exporters	State Treasury Secretary (primarily)	Processors Association (SINDICAJU)	Exporters that process cashew nuts	National and state government	National and state government budgets
State of Piauí ICMS artificial tax charge on out-of-state cashew nut trade	Use of transaction prices for ICMS charge	Piauí or Ceará State Treasury Secretary	Processors located outside of Piauí State (only part of SINDICAJU members)	Exporters in states other than Piauí that process cashew nuts	Piauí State government, Ceará State government, exporters located in Piauí	Piauí State industrial policy, Ceará State government budget
Federal PIS/ COFINS tax refund delay to exporters	Refund of all PIS credits to cashew exporters	National Treasury Minister	Processors Association (SINDICAJU)	Exporters that process cashew nuts	National government	National government budget
Rural micro credit target segment	Expansion of Agroamigo to all PRONAF categories, with working capital credit to cashew producers	National Treasury Minister and Banco do Nordeste President (headquarters is in Ceará)	Producers associations (fragmented under FAEC – Ceará State Agriculture Federation)	Small cashew nut producers and all cashew nut processors	Cashew nut traders	Operational capability of government-owned finance institutions, national government budget
Labor regulations	Reduction of social charges on the wages paid to cashew workers	National Congress	Unclear	Cashew nut producers, processors, informal workers, and unemployed	Cashew nut formal workers, national government	Change in the National Constitution

TABLE 2: BRAZIL CASHEW VALUE CHAIN REGULATION: ADVOCACY MATRIX

Regulatory Constraint	Reform Demanded *(What)*	Advocacy Aspect				
		Advocacy Level *(Where)*	Natural Champion *(Who)*	Timing *(When)*	Impact on Competitiveness *(Why)*	Advocacy Activities *(How)*
State ICMS (VAT) tax refund delay to exporters	Prompt refund of all ICMS credits to cashew exporters	State Treasury Secretary (primarily)	Processors Association (SINDICAJU)	To be determined in agreement with stakeholders	Reduced costs to processors can mean lower prices and higher market share in the international market, or improved prices for cashew producers/ processors	General CIBER meeting, follow-up individual meetings, press coverage, etc.
Federal PIS/ COFINS tax refund delay to exporters	Refund of all PIS/COFINS credits to cashew exporters	National Treasury Minister	Processors Association SINDICAJU		Reduced costs to processors can mean lower prices and higher market share in the international market, or improved prices for cashew producers/ processors	General CIBER meeting, follow-up individual meetings, press coverage, etc.
Rural micro credit target segment	Expansion of Agroamigo to all PRONAF categories, with working capital credit to cashew producers	National Treasury Minister and Banco do Nordeste President	Producers Associations (fragmented under FAEC – Ceará State Agriculture Federation)		Reduced financing costs can improve small producers' productivity levels and standards of living	General CIBER meeting, follow-up individual meetings, press coverage, etc.

ers is the Ceará State Agricultural Federation, or FAEC). The main obstacle to addressing the micro credit issue remains the operational ability of government banks to deploy PRONAF credit funds effectively.

Managing advocacy for reforms

DAI prepared a draft action plan for discussion with industry stakeholders to determine how to advocate for the suggested reforms (Table 2). Such a meeting serves as the starting point to promote the reforms, triggering further action-oriented meetings between the natural reform champions and the decision makers within the institutions responsible for changing the regulations.

Other applications: nontimber forest products in Serbia

Serbia has a centuries-old tradition of collecting and exporting wild-grown gourmet mushrooms. The practice provides seasonal employment for up to 100,000 people, mostly in poor rural areas lacking employment opportunities. The forest mushroom chain accounts for roughly 0.5 percent of Serbia's total exports to the European Union (EU), worth roughly $22 million per year. The value chain is simple: collection (sometimes augmented by imports), assembly, transport, packaging, some processing (drying and brining), and delivery to customers in the EU. Producers have generally stayed away from value-added products.

Value chain stakeholders and CIBER researchers identified three business environment issues with the potential to affect competitiveness: a quota system, inflexibility in export licenses and border crossings, and inconsistent regulatory treatment of mushroom imports for re-export. The quota system was quickly eliminated from the list scheduled for further analysis. While the state establishes and allocates quotas for the collection of mushrooms (and other wild nontimber forest products), participants in the value chain realized that the quota system in effect protected their livelihood, and felt that the allocation process was sufficiently transparent.

Restrictions on border crossings can pose a problem. Exporters are required to get their export permits long before the actual shipment, at the time when they receive their quota allocations. These permits require the exporter to specify the buyer and the border crossing point among those with CITES (Convention on International Trade in Endangered Species) inspections facilities. Unfortunately for exporters, by the time the mushrooms are ready for export, the buyers may have changed, which may render the specified border crossing inconvenient. Yet authorities may turn the truck back if exporters attempt to use a crossing that differs from the one listed on the permit. Both exporters and government officials are aware of the problem, and it tends to be handled in a reasonably flexible manner, but the regulation remains on the books. The information available on this issue did not permit an appraisal of cost or quality implications, beyond viewing it as an avoidable complication; dialogue between exporters and state institutions is already under way.

Regarding the temporary imports of mushrooms from neighboring countries, regulations impede Serbia's mushroom exporters from maximizing their capacity to package and process imports for re-export. Mushrooms are naturally radioactive and Serbia imposes a significantly stricter standard on imports of radioactive materials than other countries, including the EU. Meanwhile, health authorities treat the temporary imports of mushrooms like permanent imports into the country. As a result, Serbia's health authorities reject imports that would meet EU standards, and prevent companies from processing and re-exporting. According to industry sources, the standards are under review.

Addis Ababa's handloom weaving

With a population of some 3 million people, Addis Ababa is home to more than 30,000 traditional handloom-weaving micro and small enterprises (MSEs), producing apparel (shirts and dresses), accessories (scarves and shawls), and household fabrics (window curtains and pillow cases) (Central Statistics Agency of Ethiopia 2003). The country's vibrant and growing tourism and export markets present two opportunities for weaving MSEs. However, weavers face several constraints in responding to these end market demands: weak vertical linkages, dysfunctional business service markets, and an unevenly administered regulatory regime that makes informality the default status of many Ethiopian MSEs.

A minority of weaving MSEs are members of commercially viable, formal business associations (called "cooperatives" in Ethiopia) that supply high-end local retailers and exporters, but these typically operate informally and struggle to sell their products profitably via local outlets such as open-air markets. The most successful weaving cooperatives supply products to high-end local retailers and/or exporters that in turn provide a variety of key inputs:

- Information on end market consumer preferences (for example, design trends and quality standards);
- Product prototypes that the cooperative is asked to replicate in large quantities;
- Production materials such as high-quality cotton yarn and silk; and
- Product transportation to the end market.

In seeking to help cooperatives achieve stronger horizontal and vertical linkages and enhanced competitiveness, a central obstacle is the business environment within which weaving MSEs function. Critical competitiveness constraints include anti-competitive practices by Ethiopia's largest weaving input supplier and unreliable access to U.S. Africa Growth and Opportunities Act (AGOA) export visas.

With regard to anti-competitive practices, the CIBER analysis identified monopolistic practices at the cotton yarn wholesale and distribution stage of the value chain. According to stakeholders in the value chain, a certain company was artificially driving up the price of cotton yarn by stockpiling the product in warehouses and releasing inventory on a limited basis to create the illusion of a supply shortage. One exporter reported that the cost of a bale of cotton yarn had more than doubled between September 2007 and March 2008. Concrete steps should be taken to reduce anti-competitive forces in the Ethiopian economy. The monopolistic company mentioned above offers a high-profile target for donors and other stakeholders to work with Ethiopia's government in implementing and fully enforcing the country's competition law.

The issue with respect to AGOA export visas is availability. One of the six leading exporters of traditional hand-woven textiles is targeting the U.S. market under AGOA. Every shipment to the U.S. buyer requires an AGOA visa that allows the shipment to be received tariff-free when it arrives in the United States. However, only one individual at a single location in Addis Ababa is certified to issue the AGOA visa, and his presence in the office is unpredictable—a big problem for exporters because their shipments are time-sensitive. A delay of two or three days can make the difference between a shipment for which the company receives payment and an order cancelled by the importer. Greater reliability and predictability in the AGOA visa provision process should be a high-priority intervention. While the impact on competitiveness can only be described in qualitative terms at this point, exporters of hand-woven textiles clearly have a case and an incentive to advocate reforms.

To sum up, the CIBER analysis used in each of the above cases pinpointed key issues affecting the competitiveness of the selected products. In some cases, this analysis led to the development of reform approaches; in others, it supported the case for increased transparency in either the public or private sector. At any stage in the life-cycle of donor-funded programs, CIBER can assist in identifying and implementing long- and short-term reforms to provide both "quick wins" and deeper, more systemic changes to create a more enabling business environment.

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BUILDING AN ENABLING ENVIRONMENT FOR AGRIBUSINESS IN INDONESIA

by Pantjar Simatupang and David Anderson

Identifying constraints and gaps: A value chain perspective

Agribusiness value chains in Indonesia already play a significant role in the country's economy. They can compete effectively in world markets, but they still tend to fall short of taking full advantage of opportunities. The U.S. Agency for International Development (USAID) has been providing assistance to the development of selected value chains under its Agribusiness Market and Support Activity (AMARTA). AMARTA was designed to increase productivity, improve product quality, and enhance access to markets for the following nine value chains:

- Cocoa/cocoa products;
- Horticulture products for domestic supermarkets;
- Beef cattle production for the domestic meat market;
- Marine aquaculture;
- Specialty and organic coffee;
- Natural rubber;
- Seaweed;
- Floriculture; and
- Biofuels.

Initial reviews suggested that inappropriate government policies and regulations constitute one of the most significant obstacles to agribusiness competitiveness in Indonesia. Tackling these shortcomings in the business environment therefore became a major concern of the assistance program. AMARTA adopted an approach that emphasized an "inside-out" perspective—identifying constraints and gaps from the perspective of the stakeholders in these value chains. AMARTA advisers surveyed value chain stakeholders to review the business environment and pinpoint weaknesses that jeopardized the chain's competitiveness. The responses highlighted weaknesses in the policy and regulatory environment that may be grouped into four major categories:

Underinvestment in public infrastructure and services

- Research and extension systems do not exist or are ineffective in providing information.
- Irrigation services for non-rice crops are lacking or inadequate.
- Maintenance of access roads (farm-to-market roads) is poor or completely ignored, costing farmers money and time.
- Weaknesses in rural financial institutions severely limit access to finance, and any interaction with the financial system is burdensome.

Cost-inducing regulations

- Local governments impose their own taxes and fees in transportation.
- Regulations regarding seed importation and new variety release are complex and difficult to understand.

Weak policy and regulatory enforcement

- Fertilizer policies often disrupt supply systems.
- Illegal road taxes and other informal fees raise the cost of transportation and impose risks.
- Authorities fail to establish adequate regulations for seed quality and purity; where regulations exist, they are not enforced through inspections.

Improper public investment

- There is virtually no stakeholder involvement in planning and use of public investment in the sector.

- As a result, public investments fail to meet actual needs in terms of appropriate design, location, or purpose.
- Operational management tends to be inadequate, is usually directed by local government agencies that lack appropriate competencies, and is seen as fearful of private sector involvement.

The issues raised by value chain stakeholders are primarily local governance issues. The main problems underlying all of them arise from a lack of public participation, pressure, and control in formulating programs and in implementing and enforcing policies and regulations. Ultimately, the problems are rooted in underdeveloped or non-existent agribusiness interest organizations in the local regions—particularly farmers' organizations and industry associations—to challenge regulations and policies and provide better guidance.

Establishing forums for public-private dialogue

Support under USAID's AMARTA project has therefore concentrated on establishing mechanisms or forums for public-private dialogue on agribusiness development programs, policies, and regulations. Key to launching and reinforcing this dialogue was the creation of Regional Agribusiness Competitiveness Alliances (RACAs). The name implies a focus on local governance issues, and RACAs have been established at the level of the regency (a local administrative unit, or kabupaten) and province, as well as at the national level. The public-private dialogue must involve all three layers of the government structure because each layer has discretionary power to make policy and regulations and to implement development projects.

The RACA approach aims at creating a system of contestable governance in areas that affect the competitiveness of agribusiness value chains by fostering policy advocacy and watchdog roles by nongovernmental organizations (NGOs). A RACA's scope can be specific to a sector (or industry), a commodity, or an agro-ecosystem, depending on the congruence between AMARTA's focus of interest and the regions' realities.

The basic design of a RACA seeks to ensure a balanced representation of all stakeholders. Participants fall into three groups:

- Agribusiness producer organizations (farmers, traders, and processors);
- Policy makers, rulemaking authorities, and administrative agencies (government institutions); and
- Agribusiness development interest groups, which include consumers and development institutions.

A RACA's principal charge is to provide a focused forum for the policy regulatory dialogue involving all stakeholders. The elements of this dialogue include participation in open-ended workshops and discussions, parliamentary hearings, and institution-by-institution lobbying. The RACA also participates in the ongoing development planning dialogue, such as that of the Multi-Stakeholder Consultation Forum for Development Planning (Musyawarah Rencana Pembangunan, or Musrenbang),[1] which encourages public participation in planning and budgeting processes. As the RACAs go through the process, the end result is a structured organization with a secretariat (supported by the project) and elected committee members that become agribusiness interest advocacy organizations.

To assist in the formal establishment and empowerment of each RACA, the project provides assistance in organization development, which includes consolidating member organizations and establishing the RACA's secretariat, statutes, and registration. AMARTA also offers support in devel-

[1] Supported by USAID's Local Governance Support Program.

oping the institutional capacity of the RACA, such as training programs to develop skills in proposal writing, advocacy techniques, and public speaking.

The RACA process

The initial step in the RACA process is a problem assessment, commissioned by AMARTA. The assessment looks at the commodity value chain and broader economic issues. It is designed to identify the potential production region's strengths, weaknesses, opportunities, and threats, including policy and regulatory issues at all levels of government structure.

The initial problem assessment serves as the basis for the first round of stakeholder workshops at the national, provincial and regency levels. With support from AMARTA, the workshops emphasize awareness creation, involving the stakeholders, and identifying potential leaders. The participants discuss the assessments and identify policy and regulatory issues in a group setting. The workshop also serves to inform all stakeholders of the mission of the project and planned interventions. The feedback on these planned interventions, including the establishment of the RACA, is used to adjust plans and build broad ownership.

This initial round is followed by a focused policy assessment, reviewed in a policy workshop, that serves to stimulate the establishment of an organized policy advocacy. The product of this discussion is a workable policy advocacy agenda.

Policy and regulatory advocacy

In collaboration with appropriate government agencies, the RACA emerges as the forum for examining views on the policy and regulatory issues raised in the previous workshops. Part of the process includes the development of champions for selected issues. AMARTA assists in preparing advocacy materials, such as policy white papers, and supports the process of the policy dialogue through parliamentary hearings, discussion with relevant government institutions, publicity, and follow-on activities.

Challenges

Establishing a RACA is not an easy task in Indonesia—and probably would be no easier in most other developing countries. Among the major challenges are:

Farmers have limited capacity to develop a strong organization. The reasons include:

- **Financial constraints:** prevailing poverty limits farmers' ability to support RACAs with financial resources.
- **Knowledge constraints:** many of the value chain participants have limited education and lack the ability to perform policy analysis; and
- **Narrow focus:** many of the stakeholders narrowly pursue their own interests.

Official government support is lacking. Here, too, there are several reasons:

- **Vested interests:** there is a suspicion that policy and regulatory decisions may increase competition and reduce monopoly power.
- **Self-protection:** many of the government stakeholders are also beholden to their own short-term self-interests; and
- **Ideological tensions** among political parties.

Consistent support from development institutions is needed to help bring a RACA-type initiative to fruition.

Accomplishments

The RACA process has registered a number of achievements. At the regency level, Karo Horticulture Community in Karo Regency, North Sumatra, has begun to address policy and regulatory issues related to horticulture. The Karo RACA represents a group of collaborating champions, including local farmers, agribusiness leaders and traders, clergy, media professionals, village clerks, and academic activists. The establishment of this RACA has been the key factor in involving farmers and agribusiness producers in the making of development policy.

The Karo Horticulture Community held a public hearing with the local Parliament on April 9, 2008, where they presented a white paper on horticulture policy. This initiative was appreciated by both the Parliament and local government as a new and very acceptable approach to pursuing a policy and regulatory advocacy initiative, in contrast to the tradition of open conflict, characterized by street demonstrations by various NGOs. Both bodies promised to use the white paper as a main reference in formulating future policy and development programs. As an early result, the Parliament has agreed to allocate funds for the development of farm roads proposed by the Karo Horticulture Community. A valuable lesson from this experience is that structured, formal public-private dialogue could be more effective than press pressure or street demonstrations in advocating a better policy and regulatory environment.

AMARTA also collaborated with the Subak Abian Association—an indigenous farmer organization for dryland farming—and the regency government in establishing the Tabanan Cocoa Community Alliance, a cocoa-based agribusiness RACA in Tabanan regency, Bali. At the alliance's request, the regency government revised its budget plan to finance construction of three units of cocoa dryers as a replication of technology AMARTA had introduced in the locality. In Deli Serdang Regency, the public-private dialogue on policy and regulatory issues affecting horticulture competitiveness led to the establishment of the Deli Serdang Banana Community, which has been launched by the regency's Office of Agriculture with AMARTA support.

At the provincial level, an unstructured type of RACA has started a dialogue on the automatic detention of Indonesia cacao exports in U.S. ports. And at the national level, the RACA process, working with the Directorate General of Horticulture, promoted the establishment of the National Horticulture Board. Another national program, involving sub-terminal agribusiness (packing houses) and cool storage development projects, can be viewed as a RACA for advocating appropriate government development programs, in collaboration with the Directorate General of Processing and Marketing of Agriculture Products and regional governments. Finally, also at the national level, the emergence of the Specialty Coffee Association of Indonesia has primarily involved the private sector.

The experience to date suggests that RACA-like institutions, operating at the three levels of government and driven by the concerns of targeted value chains, should be viewed as an essential component of an ongoing agribusiness development program. The lessons learned in Indonesia apply to many other developing countries. The institutional nature of the RACAs ensures greater transparency in the policy-making and regulatory process. It also serves to address the challenges at the level of the value chain participants in terms of knowledge and resources. RACAs have become a key instrument for creating an enabling business environment that enhances, rather than hinders, the competitive performance of Indonesian agribusiness.

BUILDING PUBLIC-PRIVATE COALITIONS TO PROMOTE REGULATORY REFORM

by Denis M. Gallagher

Bottom up vs. top down revisited

Virtually any regulatory reform initiative involves some dialectic between "bottom-up" and "top-down" approaches. From the bottom up, businesses tend to work directly with local administrations in identifying opportunities for reforms and promoting their implementation. As these initiatives demonstrate that change for the better is possible, pressure builds on government and parliament to make the reforms economy-wide and to address legislative obstacles. In contrast, a top-down approach may emerge from a commitment by the government—often a new government or one that has adopted new ideologies—to reduce the regulatory burden on business. In the 2006 issue of *Developing Alternatives*, I argued that a top-down approach to regulatory reform works when "the stakeholders agree" (Gallagher 2006). However, even an innovative regulatory reform strategy from above based on the best practices of political and economic science is bound to be stuck if it lacks an appropriate response from below. Without some interaction between top-down and bottom-up actors—between the public and the private sectors—regulatory reform sputters.

Consequently, a major challenge in promoting regulatory reform is the creation of a broad-based reform network. In this essay I explore the essential ingredients in political economy needed to build public-private coalitions to promote and implement effective regulatory change. DAI's work over the past decade in Palestine and Eastern Europe offers a number of critical lessons. Most recently, in Egypt, the early and promising success of the Egyptian Regulatory Reform and Development Activity (ERRADA) has ignited an ember of community spirit among progressive private and public leaders.

Coalescing around unifying issues—provided they exist

Effective coalitions have a common thread: they address unifying issues, platforms, or threats to fuse disparate parties to work together for mutual benefit. This applies across the board to coalitions formed in many spheres of public life, whether in community development, political movements, or military campaigns. The need to distinguish a tangible issue upon which to unify public and private sector stakeholders in promoting regulatory reform is no less important.

Following the end of the Cold War and the collapse of the state socialist system in Eastern Europe, the unifying issue for the new states and new governments was eventual membership in the European Union. The prospect of real investment from market openness and integration into the "common market" provided the focus around which coalitions for regulatory reform developed within and between the private and public sectors.

In West Bank/Gaza, both the public and private sectors embraced the vision of an independent state under the Oslo Accords. On the economic side, the focus was on promoting investments within the economic parameters of the adjunct Paris Protocol agreement. The political and economic visions combined to define the overarching issues that drove government and businesses to unify in an attempt to build a reformed and distinctive regulatory environment.

For Egypt, alas, no such high-profile issue is readily apparent. Building competitiveness, creating jobs, protecting the environment, and expanding social and democratic rights and duties are all worthy goals but fall far short of driving a dynamic coalition for reform. Not that the lack of an existential threat or opportunity is an excuse for reform leaders to do nothing to build a progressive coalition of the public and private sectors; it just makes it more difficult.

Advocate or implement?

Textbook wisdom holds that the principal purpose of public-private coalitions is to advocate reforms. But public advocacy may not be the route to take. It may seem counterintuitive, but public advocacy for regulatory reform in Egypt and much of the Near East is a stale and possibly toxic activity, inviting cynicism and almost certain failure. Regulatory reform is often used as a proxy tagline within a complex reordering agenda. Skepticism about this topic has been reinforced by the heralded regulatory gaps revealed in the global financial crisis. Thus, overreliance on public advocacy for regulatory or policy reform as a first step may well end up being the last step to failure.

The more pragmatic path evolving in Egypt is to persevere, with little fanfare, in making incremental progress in achieving specific, measurable, and recognized regulatory reform goals that build credibility among Egyptian stakeholders. This approach also gives the reform leadership confidence to expend political capital. It represents a deliberate inside-out strategy that relies on implementation to build a growing awareness of the necessity for regulatory change internally within the public-private sector stakeholder coalition. What can we learn from both the outside-in profile in play in Eastern Europe and West Bank/Gaza and the inside-out approach of Egyptian leaders? Advice on building coalitions for regulatory reform must respect the environment, both political and cultural. There is no “one size fits all” reform strategy.

Developing a strategic framework for regulatory reform requires borrowing best practices from strategic marketing and small and medium-sized business start-ups:

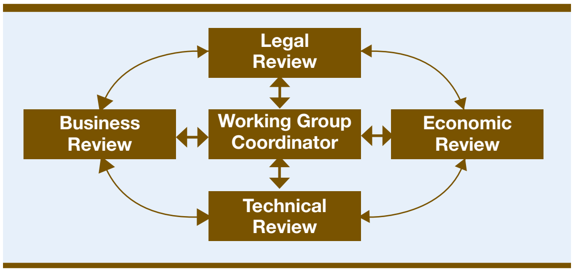
- Undertake wide-ranging consultations with the leaders of the public and private sector stakeholders to assess their appetite to engage in the reform process (market research).
- Forge consensus on the concrete regulatory reform goals, objectives, and timelines for communicating achievements (sales forecast).
- Make hard, pragmatic assessments of the technical skills, institutional alignment, and financial resources required to undertake a wide array of innovative and mundane activities that result in regulatory change (working capital).
- Finally, guard against misusing the term “public-private partnership” when advocating and implementing regulatory reform to avoid confusion over the rightful roles and responsibilities within such a partnership (branding).

Public good vs. private gain

Is a public-private partnership to promote regulatory reform really possible? If it is possible, is it a good relationship to foster, or is there an inherent moral hazard, a possibility of regulatory capture, or, even worse, a possibility that it will lay the foundation for systemic corruption? Simple answers to these questions do not suffice. What may be more useful is to go beyond the slogan of public-private partnerships and recognize who the public and private sector stakeholders are, respecting their distinctive roles and responsibilities.

The public sector includes ministries, authorities, and agencies or other institutions that act as public regulators; it does not refer to political bodies such as parliaments, assemblies, or councils where either elected or appointed members deliberate on policy. As for the private sector, it may be inappropriate to limit the term to refer only to organized business or trade groups; the private

FIGURE 1. PUBLIC-PRIVATE WORKING GROUP—BUILDING BETTER REGULATIONS



sector may also encompass professional societies that may retain a legally recognized accrediting function, as well as researchers from established institutes or nongovernmental organizations and academic professionals. Ad hoc or single-issue advocacy groups or similar civil society organizations may be problematic to incorporate in a public-private coalition for regulatory reform. Their often critically useful activities are best directed toward political bodies where policy positions are deliberated and paths set.

The schematic above depicts a rudimentary mechanism by which a public-private coalition in regulatory reform can be put into practice within a working group as a form of virtuous circle. The key ingredients for progress include 1) respecting the roles and responsibilities of the coalition's members; 2) clearly determining (and putting in writing) the contribution, agreement to, and ownership of the evidence-based methodologies used in a regulatory review process; 3) recruiting and financing the executive staff and expert resources needed to engage meaningfully in the process; 4) nailing down the timelines for achieving agreed reform recommendations; and 5) identifying the political and economic levers to achieve reform.

Results from the field

The overview of the architecture required to build effective public-private coalitions for regulatory reform provides the backdrop for examining particular experiences in the field. The remaining sections provide a quick sketch of how similar coalitions were built or are being built in Moldova, Palestine, and Egypt.

Moldova: State Commission for Regulatory Reform

The Moldovan regulatory reform program is explicitly enshrined in a law that was designed and promoted by powerful individuals in government. The program is openly supported by a near-unanimity in Parliament and backed by a President with strong roots in the Soviet era. This very top-down approach mandated 50 percent private sector membership in the State Commission for Regulatory Reform and its operating arm—the National Working Group—and clearly reflects a national consensus on the political economic strategy for Moldova.

This top-down reform apparatus is also underpinned by the European Union (EU) Moldova Action Plan within the context of the European Neighborhood Program, which helps shape many of the country's policy programs and the reform process. The importance of these agreements has been heightened since the borders of the EU reached Moldova with the accession of Romania on January 1, 2007. By design or coincidence, this regulatory reform program is also noted in the January 24, 2007, "IMF/Moldova: Letter of Intent and Memorandum of Economic and Fiscal Policies and Technical MOU" as a measure of progress that prompted the re-engagement of the International Monetary Fund with the Republic of Moldova.

Nevertheless, given the legacy of the Soviet era, many independent business and professional organizations emerging in Moldova were initially hesitant to spend sufficient time and resources on the regulatory reform process. Even armed with a strong, legally mandated voice, the private sector needed to be cajoled, enticed, and gently threatened to engage.

This reluctance of the private sector partners in the reform coalition to engage was successfully addressed through an aggressive public advocacy campaign to "join in" and participate in the institutions and mechanisms already in place to give effect to reform (http://www.bizpro.

md/). The campaign was further strengthened by the ongoing work of the Moldovan branch of the International Association of Business and Parliament, which is active in linking parliamentarians to the regulatory reform process (http://www.iabp.org/).

West Bank/Gaza: National Economic Dialogue Program

The complexities of the Middle East peace process and the very long and winding road to establish the State of Palestine form the backdrop to a vigorous program of policy and regulatory reform under way in the West Bank (Silverburg 2002). Prior to but continuing beyond the outbreak of the Intifada in 2000, the private sector—under the umbrella of the Palestine Trade Centre (Paltrade)—came together to petition the Palestinian Authority for a "root and branch" review of the policies and regulatory powers affecting the business community (World Bank Group 2000). Under the direction of Samir Abdullah, then the Executive Director of Paltrade (now Minister of Planning), 15 "white papers" were commissioned from leading Palestinian academics and researchers addressing prioritized legal and regulatory impediments to investment in West Bank/Gaza (http://www.paltrade.org/en/).

The coalition-building aspect of this reform lies in the open discussion, debate, and voting during the first National Trade (later Economic) Dialogue Program (NEDP) conference, where more than 400 business, government, and professional civil society leaders—supported by the international community—met for two days in Ramallah the late autumn of 1999 to agree on the terms of reference for the white papers as well as their priority. More than 30 ideas were submitted by both public and private sector stakeholders (Bouillon 2004).

The NEDP conference was re-convened in June 2000 and the assessments and recommendations within the white papers were again discussed, debated, and voted on by the more than 400 delegates. These delegates included most of the economic ministers of the Palestinian Authority as well as the prime economic advisor to then-Chairman Yasser Arafat.

This process proved highly successful in forging a strong public-private coalition that—although overshadowed by the tragedies of the Intifada—endures as an ongoing reform process, as the recent third NEDP conference has demonstrated. However, the conference is only an indicator of the catalytic effect that a successful reform coalition may achieve.

In West Bank/Gaza, a dynamic information technology (IT) community of young, internationally linked entrepreneurs is at the forefront in the pursuit of best regulatory practice, as demanded by the IT industry. Represented by the Palestine Information Technology Association (www.pita.ps), this group also includes a flourishing branch of the Internet Society (ISOC) and the unique pre-blogger forum of the Palestine Information Technology Special Interest Group (general@itsig.org). The latter group brings together more than 500 professionals worldwide who have an interest in the development of policy and better regulation to foster the benefits of IT in West Bank/Gaza and beyond.

The key lesson learned from the Palestinian experience is that the fusing of traditional reform mechanisms, such as the use of "working groups" and "white papers," with IT, and the clever media management of open forums where appropriate, can greatly enrich the forward thrust of the regulatory reform process.

Egypt: Regulatory Reform and Development Activity

The term "ERRADA" means "the will"—the initiative's key goal is to build an Egyptian regulatory management system of public-private institutions based on openness and fairness that promotes a competitive Egyptian economy. ERRADA is a mechanism for regulatory reform and more; it is a national effort to establish a dynamic environment where companies and individuals, Egyptians and foreigners, can build their futures in confidence. The emergence of a more just, efficient, and competitive Egypt will inevitably unleash the innovative talents and skills of Egyptian enterprise, which will provide better job opportunities for a growing population.

The origins of ERRADA lie in the groundbreaking series of discussion forums sponsored by the Egyptian National Competitiveness Council in March 2007 to assess the regulatory burden affecting Egyptian businesses. A roundtable meeting of key stakeholders produced a conceptual framework and principles for government to embark on a program of rapid regulatory reform that was elaborated in the fourth *Egyptian Competitiveness Report* of May 2007.

This process of rapid regulatory reform will support national and firm-level competitiveness. It relies on incorporating evidence-based reviews of existing and newly proposed regulations from three sources. The primary work and first review will be conducted by specialized government management units (GMUs) within participating ministries that will build an inventory and review all regulations under their ministers' authority; a second review will be carried out by coalition stakeholder organizations represented on the Business Advisory Council (BAC); and a third, synthesis review will be undertaken by the independent general review unit (GRU) that oversees ERRADA. The GRU will recommend amendments and compile the national registry of regulations.

The Agenda

Although the vision for what ERRADA is designed to achieve is far-reaching, the strategic and measurable goals of the initiative are fairly simple:

- Assemble an inventory of all laws and regulations in each participating ministry that affect individuals and businesses.
- Review this inventory within a public-private triage or coalition of 1) special ministerial units (GMUs), 2) a central independent body of experts (GRU), and 3) a coalition of private business and professional organizations (BAC).
- Demonstrate an open process of inventory and review by allowing internet access to an electronic registry of laws and regulations affecting business in Egypt.
- Lay the groundwork of systems, institutions, and principles for the effective use of regulatory impact assessment (RIA) as the foundation of economic governance in Egypt.

The agenda creates a transparent process for simplifying Egypt's regulatory regime to support economic growth and competitiveness. It is designed to rapidly count and review a large number of regulations against agreed filters, to eliminate regulations that are no longer legal or contravene national policy and international obligations, or, as importantly, to simplify regulations that are too complex to support competitiveness and investment.

The Progress

Political leadership from the sub-Cabinet Committee of the Productive Sector, chaired by the Minister of Trade and Industry, provides the bedrock to turn concepts and principles of regulatory reform into actions that produce results. Eleven ministries currently participate in the initial phase of ERRADA through publication on February 17, 2008, of a joint interministerial decree (Committee of the Productive Sector) to create ERRADA and the GRU Board of Trustees.[1] The Government of Egypt has also taken the lead by allocating E£16.7 million from the Minister of Finance to underwrite the work of the ERRADA institutions.

From this support has grown the network of dedicated GMU teams of economists, lawyers, and IT specialists in each ministry. These 60+ reform

[1] The Ministries of Trade and Industry, Finance, Transport, Tourism, Investment, Health, Housing, Agriculture, and Petroleum, and the Ministries of State for Local Development and for Administrative Development.

experts have been extensively trained in inventory and review techniques and have been equipped with an integrated suite of information and communications technology (ICT) hardware and software tools developed for ERRADA. ERRADA management has also built the independent GRU, whose staff of 25 lawyers, economists, and management experts provide vital coordination for the inventory, review, and needed amending of Egypt's stock of regulations via the ERRADA process.

The need to build a knowledge base and consensus on the way forward for ERRADA is crucial and has been met through study visits to Croatia and Moldova, where both governments had recently undertaken comprehensive programs in regulatory reform, and through participation by ERRADA management in Organisation for Economic Co-operation and Development (OECD) forums held in Istanbul, Amman, and Cairo on regulatory management and reform in the framework of the Good Governance for Development (GfD) in Arab Countries Initiative. The OECD requested ERRADA to make a keynote presentation at its annual GfD meeting in Paris in October 2008 (www.oecd.org/mena/governance).

The ERRADA database is a specially designed integrated network linking all GMUs and the central GRU main server at the GRU offices in Cairo. Progress is strong: 15,000 regulations (dossiers) have been incorporated by the GMUs on the database (as of October 2008). From this base, ERRADA management estimates there will be 25,000–30,000 inventoried regulations affecting businesses ready for review by end 2008.

The Way Forward

The next phase of ERRADA, starting in early 2009, will likely involve new national participants such as the Ministries of Civil Aviation, Culture, State for Environment, and Manpower and Immigration. Additionally, ERRADA will be extended to the local level with pilot programs beginning in the governates of Al Fayoum, Red Sea, and Ismailia.

ERRADA's overarching objective is to help build an open and transparent regulatory environment that promotes competitiveness and job creation in Egypt. The surest way of achieving these goals is through the meaningful adoption of the principles of RIA as the norm of governance decision taking in Egypt.

Finally, ERRADA senior management takes seriously its commitment to openness and fairness in the revamping of Egypt's regulatory system. Stimulating confidence in the regulatory system and acceptance of the impact assessments among business enterprises, professional groups, and concerned Egyptian citizens affected by regulations will unleash talent and enterprise—ERRADA's ultimate goal.

Moldova, Palestine, Egypt – Where is the link?

To borrow from the Arabic, the link is in the will . . . of concerned and dedicated people from within the public and private sectors to go beyond self-interest and the norm to build quietly and at times loudly the coalition of national and community interests that are reflected in and fostered by better regulations.

The varied tools and techniques described in this essay—including working groups, white papers, online blogs, conferences, forums, study visits, and experts' essays in learned publications—are all in pursuit of policy and regulatory reform. However, a recurring danger is to become entranced with the tools or the cleverness of the techniques and lose sight of the aim of regulatory reform: installing a system of economic and social governance that is both predictable and flexible to ensure the well-being of citizens by promoting innovation and best practices.

Meeting this goal requires discipline. Architects and future builders of public-private coalitions may wish to consider the following strategies:

- **Political support strategy**—whether "top-down" or "bottom-up"—to assemble the widest coalition of interested stakeholders that can demonstrate to the political leadership, at least to cabinet ministers but preferably to the prime minister or president, that the regulatory reform coalition is of sufficient strength to warrant high-level political support.

- **Communications and consultation strategy** that is carefully measured to ensure a degree of openness that can be deliberately expanded and deepened as consensus in the coalition is confirmed in practice and political support is forthcoming.

- **ICT strategy**, which is a core strategy to the regulatory reform program and process and goes well beyond the provision of ICT hardware and software to incorporate aspects of the communication strategy as well as institutional alignment and workforce and skills development.

- **Legal strategy** to address a potentially problematic area where the professional guardians of the law can "crowd out" the contributions of related professional and technical expertise that is critical in establishing a regulatory management system that responds dynamically to scientific and technical innovation.

- **Management support strategy**, critical to defining the executive, technical, and financial resources required to develop and refine regulatory review methodologies as a prelude to the actual implementation and consultation activities necessary in the reform process.

- **Economic impact and monitoring strategy**, distinct from monitoring performance of executive staff. This activity is linked directly to sustaining strong political support through engagement with national and international indices such as the World Economic Forum's *Global Competitiveness Report* or the World Bank/International Finance Corporation's *Doing Business* assessments.

- **RIA development strategy**—the overarching strategy to install the principles and eventually the practice of regulatory impact assessment as the norm for regulatory governance and the drafting of better laws and regulations for the welfare of citizens.

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NO MORE RED DONKEYS: CATALYZING REFORM IN MOROCCO THROUGH A REGIONAL *DOING BUSINESS* ASSESSMENT

by Lara Goldmark

Morocco's skepticism toward *Doing Business* rankings

Morocco has made great strides over the past three decades in modernizing its economy and creating a more hospitable business environment. Two waves of structural reforms in the 1980s were followed by privatization in several sectors (most recently, in telecommunications), investments in infrastructure (roads and ports), and upgrading the financial sector. In the justice sector, a specialized court system has been created to handle commercial cases.

Political pressure to demonstrate that the whole population can benefit from modernizing the economy weighs heavily on the country's civil servants. The stress is shaping the outlook of government employees, who get frustrated when they hear that investors' biggest headaches are linked to government failings—red tape, lack of transparency, a justice system that moves at snail's pace. These public servants grow positively livid at talk of the World Bank's international *Doing Business* rankings. Despite decades of reforms, Morocco's ranking is mediocre at best and trails that of its peers (the country has slipped 15 places since 2004). Criticism of the index has ranged from allegations of measurement errors to charges that the *Doing Business* exercise is fundamentally biased against countries with a civil law tradition.

French observers have written extensively and convincingly about the "Anglo-Saxon bias" implicit in the *Doing Business* rankings (du Marais 2006). Arguably, the indicators that attempt to measure the efficiency of the legal system are the least useful.[1] Although the *Doing Business* team claims the indicators were developed to take into account the realities of both common and civil law systems, the "one-size-fits-all" approach makes the questionnaires hard to understand. Portions appear nonsensical to judges and lawyers in the Moroccan judicial system (aggravated by the fact that the questionnaire is in French, while the language of the justice system is Arabic). Misunderstandings of Morocco's complex civil procedures code may have led to double reporting of certain steps in Moroccan procedure.

To take an even more ideologically charged issue, consider the indicator on hiring and firing workers. A preliminary analysis by the U.S. Agency for International Development's Improving the Business Climate in Morocco (IBCM) program concluded that Morocco's ranking would rise if, for example, women and children were allowed to work unrestricted hours, and severance and other payments due to fired workers were eliminated. In Morocco, with labor unions demonstrating daily in the streets, eliminating or reducing severance payments is simply out of the realm of the imaginable.

The biggest limitation of the *Doing Business* ranking may well be the mismatch between the indicators and the real concerns of investors. How many investors really care whether it takes 2, 12, or 20 days to register a new business? As long as the procedure is relatively clear and the delay is predictable, the business registration

[1] The indicator meant to evaluate how long it takes to move through the court system is perhaps farthest from capturing the complexities of the system it is meant to measure. See, for example, Davis and Kruse 2007 or Taylor 2007.

Why should Morocco work to improve its business climate? After all, foreign direct investment is six times higher than it was in 2002, and overall economic growth has been steady over the past few years at 5 percent or higher. Morocco's leading exports are concentrated in growing markets, and an analysis of product categories shows signs of progress toward a knowledge-driven export sector. There is a case for saying that the "glass is half full."

On the other hand, Morocco still scores poorly on most assessments of its business climate relative to other countries. This ranking means that competitors are moving as fast or faster to create a business-friendly environment. The huge increase in private investment, due mostly to inflows from Arab countries, may not be sustainable. These large, high-profile projects, mostly in the tourism and real estate sectors, have not contributed significantly to an increase in long-term employment. And unemployment, particularly youth unemployment, remains a major concern. Primary agriculture, and thus volatility due to weather, is still one of the most important variables that determine how the overall economy fares each year. Most telling, entrepreneurs in Morocco report that productivity is compromised by administrative inefficiency and that many transactions—whether business-to-business, business-to-government, or among government institutions—lack transparency.

Sources: (1) Investment Trends 2003–2007. Investment Directorate, Rabat, Morocco, December 2007. (2) Two regional studies conducted in 2007 by IBCM: the World Economic Forum's Executive Opinion Survey and the Regional Economic Profiles for Meknes-Tafilalet, Souss Massa Drâa, and Oriental.

process is likely to be neither a deal-maker nor a deal-breaker. In a recent review, the World Bank's Independent Evaluation Group concluded that 1) *Doing Business* measures only selected aspects of the business climate, 2) international rankings cannot capture "country nuances", and 3) the indicators cover only some of the top constraints to business. It also criticized changes in estimation methods that interfere with tracking performance over time (World Bank 2008).

At the same time, the *Doing Business* exercise does offer several benefits. In spite of misgivings like those noted above, the indicators offer an accounting—in consistent and comparable units—of the time and cost necessary to complete administrative procedures in all of the countries measured. And while they may indeed be too narrow and selective in their focus, the indicators permit users to pinpoint administrative failures. Finally, everybody knows what the *Doing Business* ranking is, which can serve to keep the pressure on government officials charged with competing for investment on the international scene.

Launching a regional *Doing Business* assessment

However, regions of a country, and often municipalities, also compete for investments. Within a common regulatory framework at the national level, local governments typically have considerable leeway in shaping the business environment. Assessments at the level of regions or other units of local government reveal tangible differences in the quality of the business environment. Several countries have launched *Doing Business* surveys that compare selected indicators across regions of the country.[2] The first regional *Doing Business* exercise, conducted in Mexico at the request of the government in 2005, found that a number of cities scored much better than Mexico City (the location for calculating the national-level indicators). A healthy competition ensued among Mexican regions, each trying to out-reform the others.

In Morocco, recently created regions are the focus of efforts to attract investment. Regional Investment Centers (*centres régionaux d'investissement*, or CRI), created by the King in 2002, are leading the effort to facilitate domestic as well as foreign investment. IBCM sought to support these efforts by carrying out a *Doing Business* exercise in selected regions in 2006–2007. The objective was to draw attention to needed reforms and take advantage of the

[2] One other option is the Provincial Competitiveness Index, explored in Helle Weeke's, Steve Parker's, and Edmund Malesky's article in this volume.

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momentum generated by a sense of competition among provinces. Since the exercise took place within the same regulatory framework, any bias in international comparisons applied equally across the cities. The reaction inside Morocco to the findings of this internal assessment has been less skeptical than the reaction to the international rankings. As a result, it has contributed to the reform process.

The regional *Doing Business* exercise focused on four selected indicators from the 10 used in the international rankings: Starting a Business, Registering Property, Dealing with Licenses, and Enforcing Contracts.[3] The results allowed the cities of Agadir, Kenitra, Marrakech, Meknes, Oujda, Settat, and Tangiers to compare their performance with each other, with Casablanca (the site of data collection for the national ranking), and with all the other countries surveyed annually. The exercise was carried out in close coordination with the World Bank's Washington, D.C.-based *Doing Business* team. Unlike the national ranking—which relies on data gathered at a distance via phone, fax, and email—IBCM's regional study involved personal interviews with private and public sector representatives in each of the seven cities.

The analysis found that several cities surpassed Casablanca in terms of their business environment.[4] For some indicators, the difference was dramatic: the best-performing city, Agadir, ranked 51st among countries covered for Enforcing Contracts, compared to 114th for congested Casablanca. For other indicators, one or another city was an outlier: Casablanca, and hence Morocco, scored poorly on Dealing with Licenses, for example, while Tangiers lagged way behind the pack for Registering Property. Overall, the results were good news for Morocco ("we can do better" was the television quote), albeit slightly embarrassing for Casablanca and Tangiers—home to most of Morocco's investment.

Presenting the results

Given past reactions to the national ranking, as well as some differences between the preliminary results reported in the field and the final published report, a decision was made to focus not on the overall city rankings, but rather on performance by indicator. Table 1 shows the number of days it takes to complete each procedure, and the ranking using this variable only (the full ranking is calculated using time in days, cost, and other variables, depending on the indicator).

Before the regional rankings were presented at a national conference, workshops in each region shared the preliminary results, allowing local stakeholders to provide both oral and written feedback up to 15 days afterwards. The final report, *Doing Business au Maroc*, incorporated that feedback. It was presented at a national conference. Representatives of the best-performing regional government agencies were invited to share their secrets: how does the commercial court in Agadir manage to process cases twice as fast as the court in Casablanca, for instance, and why is the Urban Agency in Meknes so efficient?

Morocco as a country ranks high on the Starting a Business indicator (51st out of 175 countries), a consequence of various reforms. Among the cities, the time involved ranged from 9 to 13 days, which is relatively low by world standards. But even so, conference participants questioned these results as overstated. The director of the Kenitra CRI jumped out of his seat, grabbed the microphone, and declared it "impossible" to report a 10-day delay for something he had personally helped investors do in four hours. He invited the audience to visit Kenitra and try for themselves. The explanation lies in what is being

[3] Trading Across Borders was originally selected and studied, but dropped from the final analysis. It was decided that the administrative performance in question was dependent on the central customs administration, and therefore neither appropriate nor desirable for inclusion alongside indicators where the regional government agencies involved really did have some leeway in their interaction with business.

[4] The full report, *Doing Business au Maroc*, is available at http://tinyurl.com/7r45r2 (available in French only).

TABLE 1. RANKING OF MOROCCO'S CITIES IN INTERNATIONAL PERSPECTIVE

Indicator	Best Ranked in Morocco	Number of Days for Best-Performing Location in Morocco	International Ranking of Best Performer in Morocco	International Ranking of Casablanca (Morocco)
Starting a Business	Agadir and Marrakech	9	16	25
Dealing with Licenses (construction permits)	Marrakech	90	17	61
Registering Property	Kenitra	14	23	82
Enforcing Contracts	Agadir	300	23	116

counted. Table 2 compares the way the CRI sees the process with the *Doing Business* calculations. It shows that the CRI may not account for certain procedures required by Moroccan law and therefore considered in the *Doing Business* measurement. This type of clarification, brought out into the open by the regional study, allowed the dialogue in Morocco to move beyond the debate about methodology.

After the regional ranking

The regional comparison triggered some responses. Cities at the extreme ends of the spectrum—Tangiers, ranked last, and Agadir, ranked first—both decided to create a committee dedicated to improving (or monitoring) the region's business climate. Members of the committee included those agencies whose performance had been measured by the *Doing Business* study as well as private sector representatives who responded to the questionnaire.

Tangiers had scored poorly on Registering Property, a process estimated to take 82 days in that city, compared to only 14 in Kenitra. Notaries, who usually interact with the land titling agency on behalf of their clients, had earlier organized a street demonstration to protest the worsening service and lack of transparency at the Tangiers land titling agency. A year later, in June 2008, IBCM staff were invited by the Tangiers CRI to visit the city again. A small working group—with representatives of the land titling agency, notaries, and other professionals who had participated in the 2007 study—had championed reforms. Transferring a property title in Tangiers now takes less than a week (although the *Doing Business*

TABLE 2. HOW MANY DAYS? CRI VS. DOING BUSINESS ESTIMATES

CRI Calculation	Registering a New Business in Morocco — Two Perspectives	*Doing Business* Calculation
Handled by CRI 2 hours	Check for availability of company name OMPIC (CRI)	2 days
Not considered by CRI	Legalize statutes at mayor's office (Commune)	1 day
	Deposit paid-in capital (Bank)	1 day
Handled by CRI 2 days	**File statutes and other documents** With tax authorities (CRI): Register company statutes; Register local business unit(s); Obtain tax ID With the CNSS (CRI): Register with social security **File documents and obtain number: commercial registry** Commercial Court / First Level Court	1 day
Not considered by CRI 2 days	Announcements in the legal journal (CRI)	1 day
	Announcements in the Official Bulletin (CRI)	2 days
	Declaration of fiscal existence	1 day
	Make/purchase a company stamp (private firm)	1 day
		10 days

The Red Donkey Mentality

In Agadir, one bank requires not only a particular form from the city's own commercial registry, but also an original copy of the same form from the commercial registry in Marrakech. There was a time, before the commercial court in Agadir was operational, when it was necessary to visit the commercial registry in Marrakech for documentation on businesses operating in the Souss Massa Drâa region. Now, however, the Agadir registry provides this service to local businesses. It seems unreasonable (and redundant) to ask investors to travel to Marrakech to obtain outdated records (the commercial registries are not computerized and therefore the only way to obtain documents—or any information—from them is to show up in person or to hire someone to go for you). A bank employee asked about the requirement stated his position as follows: "I have a manual I am referring to here on my desk; it was written in Rabat and sent to me by my superiors. If it tells me to ask for a red donkey, I will ask for a red donkey!"

Source: interview with Nezih Khalil, Agadir CRI, October 8, 2008

measure may add to that somewhat by including some other procedures). The CRI has been awaiting the results of a more systematic assessment to inform the public that it has become easier to do business in Tangiers. Though less dramatic, the time required for Dealing with Licenses (construction) also appears to have improved in that city.

Officials from Agadir saw their first-place ranking as an excellent opportunity to promote their region to investors, both international and Moroccan. Newspaper articles cited the *Doing Business* study, as did the CRI's promotional media kit. The CRI created a regional *Doing Business* committee where membership represents a "goodwill pledge" to minimize delays and members are expected to take responsibility for maintaining Agadir's positive image.

The red donkey

A "red donkey" mentality still prevails in much of Morocco, and it is not limited to the public sector (see box). This mentality is the major obstacle to better service for investors. Civil servants, and even some private sector employees, too often seek to minimize their own risk rather than facilitate the processes investors are trying to navigate. Thus, instructions must be followed to the letter, even when outdated or nonsensical. In a society marked by corruption at all levels, civil servants are afraid of coming under suspicion. In most cases, their goal is to avoid being reprimanded or questioned over a decision. Proactive problem solving is discouraged.[5]

While Casablanca was not involved in the regional *Doing Business* study, except as a foil, city officials reacted to it. As the Kingdom's most populous city and commercial center, Casablanca could and did claim that "volume" was one of the obstacles to better government performance. However, the city decided to make a wager—that the high visibility of the *Doing Business* ranking could help it push forward reforms that had been needed all along. Casablanca's CRI director announced during the national conference the intention to improve the city's score, and thus Morocco's international ranking.

The Casablanca regional committee used the *Doing Business* indicators as a jumping-off point to generate a list of possible and desirable reforms. Potential reforms ranged from the simple (reduce the number of inspections needed to obtain a construction permit), to the already under way (begin operating the credit bureau), to major, long-term efforts (upgrade the commercial registries).

[5] A judge in the Moroccan commercial court system explained that for a recent case under his supervision, he worked hard to apply the spirit of the law—that is, to find a solution that would keep a struggling enterprise out of insolvency. However, now that the case is over he is concerned that someone will identify a minor procedural irregularity, resulting in an inspection of the judge's conduct. The judge in this case resisted the temptation and the opportunity for corruption; the irony is that by doing so, he becomes fair game for others who might want to teach him a lesson. Personal interview, March 2008.

Work has begun on three indicators: Starting a Business, Registering Property, and Dealing with Licenses (construction). For the Starting a Business indicator, process mapping has been completed, to be followed by focus groups and a process reengineering exercise. Committee members agreed that the objective of the exercise is not to improve the ranking for the sake of having a better ranking. The objective is to continuously improve Morocco's ability to attract and retain investors, by making regulations smarter and more user friendly. The Ministry of Housing has stepped up to the plate regarding the Dealing with Licenses indicator. In addition to the committee work in Casablanca, the Ministry has identified a relatively modern urban agency in Ifrane (part of the Meknes-Tafilalet region) that will serve as a pilot site for implementing simplified procedures.

For several reasons, the Enforcing Contracts indicator was not chosen as a departure point for reform dialogue. The indicator is complex and considers various aspects of court administration, the civil procedures code, and current practice by lawyers and judges. Some of the biggest problems identified by the *Doing Business* indicator, such as delays associated with the use of court-appointed experts,[6] are well known and difficult to solve without strong political will. The Ministry of Justice does not even accept the *Doing Business* method of counting, claiming that court-generated statistics are a more reliable measure of the time it takes to handle cases (however, these statistics are not published regularly).

Prospects

The next year will be important to watch, to see whether the pressure is maintained on the Moroccan administration to address the weaknesses and take advantage of the opportunities revealed by the regional *Doing Business* study. Perhaps the most worrying element at this stage is the lack of clarity about which national entity will channel the regional reform proposals as they emerge.

When the regional *Doing Business* committees were announced, national government officials affirmed that they would follow this work and provide the committees with an official channel for reform proposals. That channel, however, has yet to be established. Originally, the Ministry of Economic and General Affairs had volunteered to be the conduit for such a dialogue. Then it appeared that the Ministry of Industry and Commerce did not want to give up its role as the principal interlocutor on *Doing Business* topics. There is another national committee, as well, created by the Prime Minister in 2005 and organized by the national Investment Directorate. Some of the reforms proposed by this committee are relevant to the *Doing Business* indicators, others are relevant simply because they would make investors' lives much easier. The Investment Directorate currently sits under the Ministry of Commerce but will soon become an autonomous agency; at this point it is not clear what will become of the National Committee on Investment Procedures. Last, there is a ministry officially charged with simplifying procedures, the Ministry of Modernization. It would seem logical to house the national reform committee within this ministry, but given the pace at which things move in this particular institution, that might be counterproductive.

For now, the attitude of the key ministries involved—General Affairs and Industry and Commerce—has been "keep working and don't worry; when your proposals are ready we will be ready to handle them." To ensure that the government follows through on this commitment, the IBCM program makes a point of generating publicity around the reform dialogue and proposals—so the public can see that each problem it faces has a possible solution. It will then be up to the

[6] Indeed, at the national conference when the president of Agadir's commercial court shared the "secrets" of that jurisdiction's efficiency, he stated simply that they had reduced the use of experts to 12 percent of cases.

regional investment centers, the associated government agencies, private sector participants, and the general public to send a message to Rabat that it is time to move ahead.

Six observations

- *Doing Business* indicators have significant limitations but also offer some concrete benefits. Never use these indicators alone, but always in conjunction with complementary studies. Clarify methodological debates in order to move beyond them.
- The strength of reaction to *Doing Business* rankings—and the opportunity to follow up with reform work—may have more to do with how government agencies perceive their own mandate and priorities than with the scale of difference in performance.
- Some indicators are much better than others—they are simpler or more realistic and therefore easier to use as a starting point for reform.
- Private sector participation keeps things real. For example, it was the notaries' frustration with the Tangiers land titling agency that allowed everyone concerned to admit that the process was taking too long—before it became impossible not to admit it.
- A *Doing Business* exercise can be an especially useful way to engage agencies—such as the land titling agency—that usually escape the limelight and face little pressure to clean up their act.
- Maintain the pressure—otherwise government officials will quite happily fall prey to distractions once the rankings go away.

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STRUCTURAL REFORMS FOR A MORE COMPETITIVE MENA REGION

by Ulrich F.W. Ernst

Some common economic challenges in the MENA region

Arab countries in the Middle East and North Africa (MENA) diverge greatly in terms of their economies, political structure, and cultures. The richest country, Qatar, has a per capita gross national income (GNI) more than 38 times that of the poorest country, Mauritania.[1] The economies also exhibit different structures. As a group, though, they face some common economic challenges—notably, diversifying their economies and creating jobs, especially jobs for their youth.

The thrust of efforts to diversify reflects different needs among the differing economies. The petroleum-rich countries realize that their endowments will not last forever, and wide price swings present great economic risks. They are therefore pursuing strategies to build competitive industries and value chains in new sectors. Poorer countries are pursuing greater productivity in the agricultural sector. The prevailing business environment defines incentive and disincentive structures that shape diversification; enhancing these structures is therefore an essential part of any successful development strategy.

According to the International Labour Office (ILO), youth unemployment rates in the countries in the MENA region are the highest in the world (Figure 1, next page). Youth unemployment rates for the region have declined since 1997, but they still exceed those for other country groupings. The MENA countries also show the lowest labor force participation rates, at 35 to 36 percent, which may reflect a higher percentage of "discouraged workers."

As a rule, the business environment in MENA fails to stimulate investment in new activities that generate employment. It may accommodate larger operations in traditional activities, but it neither encourages small enterprise formation and growth nor attracts foreign investment in nontraditional sectors. Structural reforms—improvements in the legal, regulatory, judicial, and administrative framework—are critical if MENA is to achieve international standards of competitiveness and accelerate its growth momentum. The need for such reforms has been embraced, with varying degrees of enthusiasm, by most countries in the region.

Efforts to forge a more hospitable business environment have taken several routes across the countries in the MENA region. Region-wide efforts include the Good Governance for Development (GfD) Initiative—in collaboration with the Organisation for Economic Co-operation and Development (OECD)—and trade agreements that create new opportunities overseas, increase regional integration, and promote domestic reforms. How will resulting changes in the business environment affect competitiveness? This article approaches that question by looking at readily available (and widely discussed) country rankings in the *Doing Business* (DB) and *Global Competitiveness Report* publications.

[1] GNI estimates adjusted for purchasing power parity.

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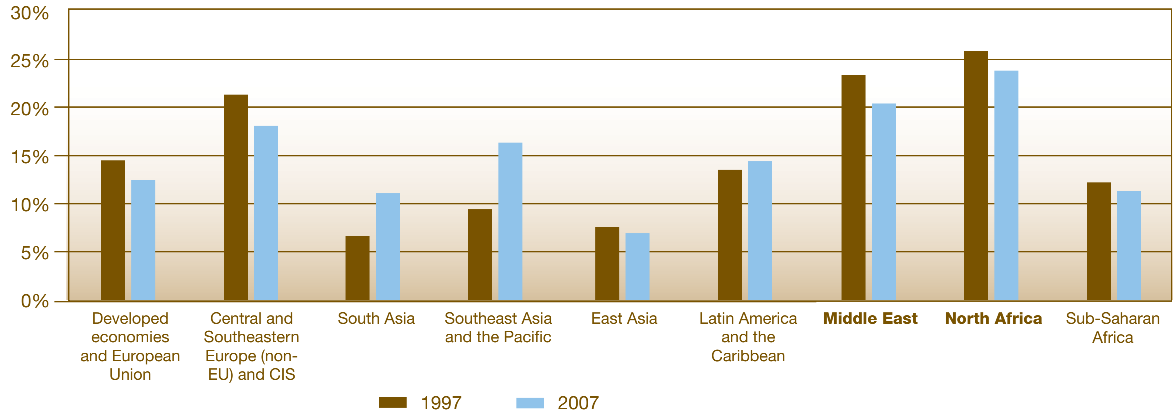
FIGURE 1. YOUTH UNEMPLOYMENT RATES, 1997 AND 2007



Source: International Labour Office, Global Employment Trends for Youth. October 2008.

Trade initiatives

The Euro-Mediterranean Union

In July 2008, the member countries of the European Union (EU) and non-EU countries of the Mediterranean rim launched the Union for the Mediterranean.[2] This Union, championed by Nicholas Sarkozy, the French President who held the EU presidency at that time, addresses a range of objectives and concerns. In the economic sphere, its principal goal is a "common market" for member countries as early as 2010. Beyond that, the Union for the Mediterranean is expected to focus on energy, security, counter-terrorism, and immigration.

The political context of the Union for the Mediterranean—both within the EU and between the EU and countries of the Mediterranean rim—is complex. However, the creation of a common market entails that the non-EU countries of the Mediterranean rim will have to take steps to meet the EU's regulatory standards, which serve as de facto standards for regulatory reform in the region.

Toward a Middle East Free Trade Agreement with the United States?

In February 2003, President Bush proposed a plan of "graduated steps" toward the creation of a U.S.-Middle East Free Trade Area. The steps build on existing free trade agreements (FTAs) with countries in the region, including Israel (1985), Jordan (2001), Morocco (2006), Bahrain (2006), Oman (signed 2006), and the United Arab Emirates (negotiations launched in 2005, now reportedly "on ice"). While the goal was originally to scale up these individual FTAs to encompass the entire region by 2013, progress has slowed and there are questions as to whether that vision can be realized.[3]

The more recent FTAs have been concluded with countries that have relatively modest trade relations with the United States. Thus, while these agreements go into considerable detail in prescribing action on a range of issues—foreign investment, government procurement, competition policy, labor and environmental matters, trade in and regulation of services, or intellectual

[2] MENA countries account for most of the EU partners in this Union, although it also includes a number of other countries, some of which are candidates for EU accession. The MENA countries are Algeria, Egypt, Jordan, Lebanon, Libya, Mauritania, Morocco, Palestine, Syria, and Tunisia; the non-MENA countries are Albania, Bosnia and Herzegovina, Croatia, Israel, Monaco, and Turkey.

[3] The United States has also concluded "robust trade and investment framework action plans" with Egypt, Iraq, Kuwait, Qatar, Saudi Arabia, Tunisia, and Yemen.

property rights—they lack adequate incentives for full implementation.

The Greater Arab Free Trade Area (GAFTA)

In an effort to compete more effectively in the world economy, Arab countries are promoting regional integration, in large part through GAFTA, launched in 2005.[4] GAFTA focuses primarily on trade among Arab countries by reducing tariffs and encouraging the adoption of common standards and specifications for the products traded internally. The adoption of common standards implies the emergence of a common quality infrastructure among the Arab states, a key element in strengthening the business environment.

The Good Governance for Development Initiative

The structure of the GfD Initiative

At a broader regional level, the GfD Initiative, launched in 2005, seeks to develop and implement a common framework for public governance reforms in the MENA countries.[5] With support from the OECD and its member countries, the GfD Initiative is aimed at adapting best practices to the economic, legal, and cultural heritage of the region. Six regional working groups define the range of activities, each led by an Arab chair and an OECD co-chair:

- Civil Service Reform and Integrity—chair: Morocco; co-chairs: Spain and Turkey
- E-Government and Administrative Simplification—chair: UAE; co-chairs: Italy and Korea
- Governance of Public Finance—chair: Egypt; co-chairs: The Netherlands and the United States
- Public Service Delivery, PPP [Public-Private Partnership], and Regulatory Reform—chair: Tunisia; co-chairs: Canada, Italy, and The Netherlands
- Role of the Judiciary and Enforcement—chair: Jordan; co-chairs: the United States and France
- Civil Society and Media—chair: Lebanon; co-chair: EU

Each working group organizes its own agenda and provides guidance for MENA countries on business environment reform.

GfD Country Action Plans

Seven of the GfD countries have prepared a "Country Action Plan,"[6] following a common format. Some of these plans are quite detailed, such as the one for Lebanon. In other cases, required actions are mapped out but the schedule is left open, or the responsible agencies remain unidentified. Yet the publication of these first Country Action Plans is a sign of progress.

Countries have acted on the measures outlined in these Country Action Plans. For example, Tunisia has launched an academic program to train legislative drafters in preparing consistent legal language in Arabic, French, and English. This légistique Master's program is open to all MENA members of the GfD Initiative. Also, studies have been done on the feasibility of establishing regional centers to address business environment reform issues across the range of topics covered by the six working groups.

[4] GAFTA members are all members of the Arab League. In addition to the Gulf Cooperation Council states—Bahrain, Kuwait, Qatar, Saudi Arabia, the Sultanate of Oman, the United Arab Emirates—it also includes Egypt, Iraq, Jordan, Lebanon, Libya, Morocco, Palestine, Sudan, Syria, Tunisia, and Yemen.

[5] The participating MENA countries are: Algeria, Bahrain, Dubai (UAE), Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Palestine, Sudan, Syria, Tunisia, and Yemen. Actual participation varies; Mauritania and Libya have not shown much interest in the GfD Initiative, and among the four Gulf states, only Bahrain is an active participant. The GfD Initiative is part of the Middle East and North Africa Initiative on Governance and Investment; the other part of the latter initiative is the "Investment Programme," aimed at improving the investment climate and policies.

[6] Bahrain, Egypt, Jordan, Lebanon, Morocco, Tunisia, and the UAE (Dubai). These action plans are posted on the OECD web site: www.oecd.org/dataoecd/21/24/37208619.pdf

GfD: A forum to face a common challenge

To date, the principal value of the GfD Initiative has been its creation of a common framework for addressing the challenge of business environment reform in the region. Sharing experiences has proved invaluable. For example, the lessons of the ERRADA Initiative in Egypt have stimulated thinking elsewhere.[7] In fact, the key outcome of the GfD Initiative may be to develop and strengthen a network of reformers in the region.

Clearly, the task of encouraging regional cooperation in pursuit of a common approach to structural reform is a tall order in an environment characterized by divergent structures and interests, both at a national and at a subregional level. Given the magnitude of the challenge, the progress achieved so far is encouraging.

Business environment and competitiveness

The path to competitiveness

The expected payoff for engaging in structural reforms is improved competitiveness, and thereby greater investment, growth, and employment. The prima facie case is persuasive: a poor business environment imposes costs on business and hampers innovation. Moving from burdensome regulation to smart regulation lowers costs and offers access to new markets and technologies—the economy becomes more competitive. But proving (empirically) how changes in the business environment affect competitiveness has proven difficult at the macro level.[8]

Even so, international comparisons of the business environment and competitiveness have attracted considerable attention, in particular the World Bank/International Finance Corporation's annual DB assessments, and the World Economic Forum's *Global Competitiveness Report*—the latter produces an index called the Global Competitiveness Index (GCI). How do MENA countries fare in these assessments, and are there any relationships between the two that would guide policy? The analysis here focuses on the GfD countries for which both DB indicators and GCI rankings are available: Algeria, Bahrain, Dubai/UAE, Egypt, Jordan, Kuwait, Mauritania, Morocco, Oman, Qatar, Syria, and Tunisia.

The business environment according to **Doing Business**

DB uses 10 indicators to define the business environment, ranging from Starting a Business to Closing a Business. These individual indicators are then summarized to obtain an overall ranking for the country. The data are not obtained through a statistically representative survey, but are collected from people "in the know"—lawyers, accountants, and other business service providers who deal with these issues on a day-to-day basis.[9]

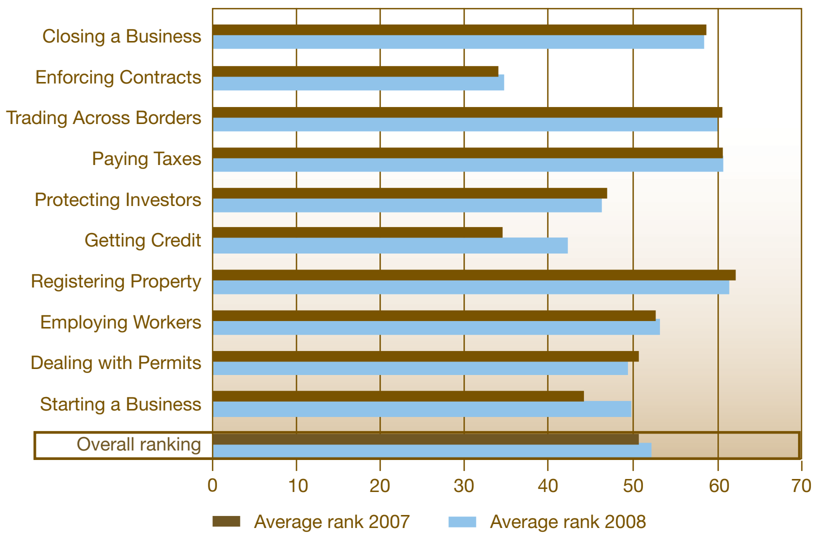
The basic data are well documented, and this specificity can provide a useful diagnostic for a given issue or bottleneck. Why, for example, does it take 75 days to complete a particular step in issuing a permit for building a warehouse? Even without embracing the overall validity of the ranking exercise, the results can be used to guide interventions. The DB team provides a "rankings

[7] See the article by Denis Gallagher in this issue.

[8] These difficulties have led to the emergence of "bottom-up"—value-chain oriented—methods; see the article by Bryanna Millis for an introduction to that approach, and the one by Pantjar Simatupang and David Anderson for an application of the value chain approach in Indonesia.

[9] Many observers have questioned the validity and comprehensiveness of the DB indicators in describing the business environment in a particular country, or, more accurately, in the country's commercial capital. A recent internal evaluation by the World Bank suggested that these measures may entail some biases, and often mix policy and implementation variables. For example, the DB indicator for Paying Taxes combines measures of the administrative burden of paying taxes (see the article by Mark Gallagher and Arturo Jacobs in this volume) and measures of tax rates. Moreover, countries with a civil-law tradition—such as Morocco and Tunisia—argue that the DB indicators discriminate against these structures. However, the DB indicators are widely accepted for international comparisons, as are the *Global Competitiveness Report* rankings, so the analysis here relies on them.

FIGURE 2. AVERAGE GFD COUNTRY PERFORMANCE ON DB RANKINGS, 2007 AND 2008



simulator” that traces the effects on a country’s overall ranking of, say, bringing down the 75 days just quoted to 30 days.

Figure 2 compares the DB scores for GfD countries in 2007 and 2008; these scores are obtained by inverting the rankings, so that a higher score means better performance, and normalizing them on a scale of 1 to 100.[10] Between 2007 and 2008, several countries in the region carried out reforms that are reflected in better indicators. Many of these reforms focused on Starting a Business, by eliminating or reducing the minimum paid in capital or by streamlining the administrative requirements for registration. Morocco gained in terms of the Getting Credit indicators by guaranteeing the right of borrowers to inspect data relating to their creditworthiness. Still, for the average GfD country, reform efforts have been offset either by slippages elsewhere or by a failure to keep up with reforms among all countries ranked by the DB team, so that the overall improvement is marginal.

The countries participating in the GfD initiative (for which data are available in both the DB and the *Global Competitiveness Report* rankings) have on average improved slightly, going from 51 to 52 on a scale of 1 to 100. The chart shows very little change, except for Starting a Business—highlighted by the reforms just cited—and especially for Getting Credit, primarily driven by changes in Dubai/UAE, which improved its score from 36 to 63, and Oman, which leapt from 36 to 88. Without these improvements, there would have been no change in the average performance for countries participating in the GfD initiative.

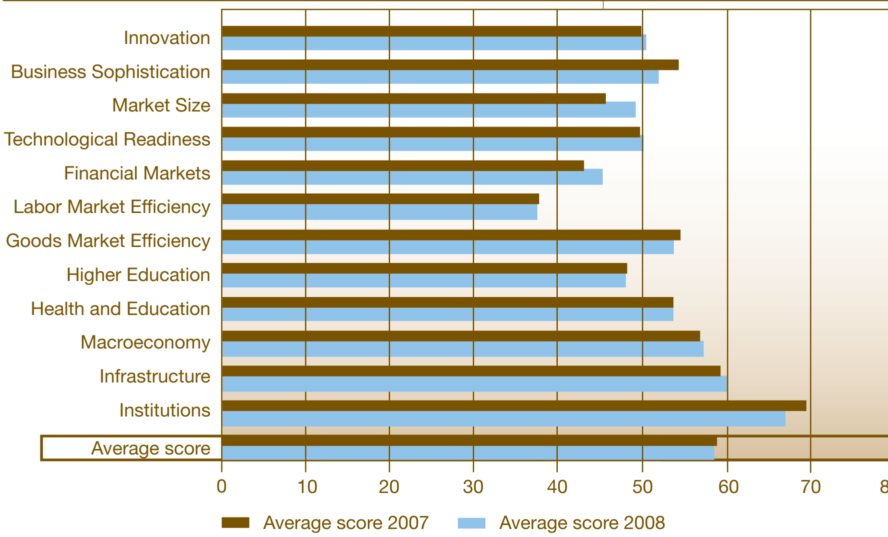
Perceived competitiveness in GfD countries

The World Economic Forum defines competitiveness as “the set of factors, policies, and institutions that determines the level of productivity in a country. Productivity describes how efficiently available resources are used and therefore the growth performance of an economy” (Hanouz, El Diwany, and Yousef 2007, 3). The appropriate measure therefore is not a single measure, but a set of factors. These factors are then summarized by applying weights that reflect the stage of development of the countries. A major input into the GCI rankings is the Executive Opinion Survey, which attempts to gauge business leaders’ perceptions of the national business environment.

The survey, which has been conducted in 134 countries, consists mostly of questions that ask

[10] Both the DB reports and the *Global Competitiveness Report* have adopted their own dating systems: *Doing Business in 2009* refers to 2008; similarly, the data reported in the *Global Competitiveness Report 2008–2009* present data for 2008.

FIGURE 3. GCI RANKINGS FOR THE AVERAGE GFD COUNTRY, 2007 AND 2008



Overall, the countries in the region score well on Institutions (the 1st pillar) and Infrastructure (2nd pillar). They do worst with respect to the Labor Market indicator (8th pillar), where the overall average is brought down by Egypt, Morocco, and Mauritania. Comparing the scores for the two years suggests that nothing much has changed on average for these countries. However, individual countries have shown greater changes in moving up and down the two scales. How are scores and changes in scores between DB and GCI rankings related?

the respondent to rank the country's performance on a scale of 1 to 7, where 1 is poor and 7 corresponds to world class. The answers depend in part on the objective situation, in part on expectations. It is entirely possible that some factor (say, infrastructure) has not changed, but expectations may have risen because respondents have seen what competitors are doing. As a result, the ranking may decline. In fact, detailed examination of patterns in these answers across countries suggests certain anomalies that are presumably attributable to differences in respondents' views of what constitutes world class standards.

The World Economic Forum uses the Executive Opinion Survey responses, together with hard data, to estimate scores on 12 "pillars." These scores and associated rankings are then combined into the overall GCI ranking. In the discussion following, the calculation of the measures followed the same procedure as for the DB scores—they are inverted and normalized on a scale of 1 to 100. Figure 3 displays the 2007–2008 GCI performance of the "average" for the 12 GfD countries included in both DB and the *Global Competitiveness Report*.

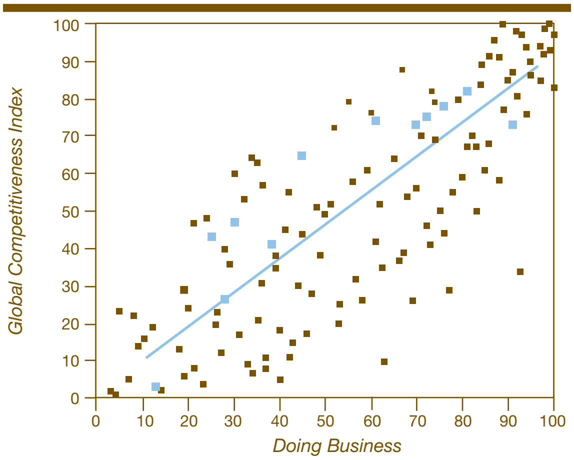
The relationship between DB and GCI scores

The overall pattern shows a relationship . . .

Figure 4 shows the relationships between the DB and GCI scores (inverted and normalized rankings) for all countries covered in both rankings. It is essentially the same chart as shown in the introduction to this issue, but the location of the 12 GfD countries has been highlighted. The blue line shows the average relationship between the two sets of measures (the result of a linear regression of GCI on DB scores, with an R^2 of 0.675).

Virtually all of the countries lie above the regression line—in other words, business executives rank the competitiveness of their country higher than would be expected on the basis of the country's DB scores. The only countries that lie below the line are Bahrain and Mauritania (Algeria is the country right on the regression line). The biggest deviations from the average line are Jordan,

FIGURE 4. THE RELATIONSHIP BETWEEN DB AND GCI SCORES FOR 2008



Note: The graph shows all 129 countries for which both DB and GCI rankings are available. The highlighted dots refer to the countries of the MENA/GfD region.

Morocco, Syria, and Tunisia. But the relationship is there; the Pearson product moment correlation coefficient for the 12 countries is a 0.902, which implies that their rankings according to the DB and GCI scores are closely related.

. . . but there is no pattern for changes over time

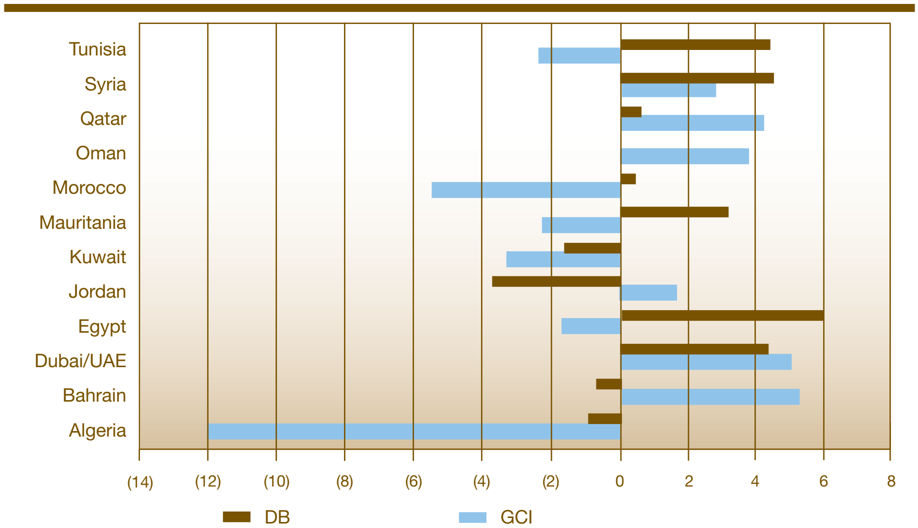
Figure 5 compares the changes in the two sets of aggregate scores. It is obvious that changes in DB and GCI performance in the short run are independent of each other. In fact, if we plot the two sets of changes in a scatter diagram, we find that four countries improved their DB scores, but registered negative changes in their GCI scores; three countries improved on both; and two countries each experienced a drop in the DB scores, and either improved or lost on the GCI scores. The twelfth country (Sultanate of Oman) improved its GCI score with no change in its DB score.

Does regulatory reform affect competitiveness in MENA countries?

Are changes in the business environment (DB) reflected in changes in perceived competitiveness (GCI)? The answer, using the two sets of data we have, is no. There appears to be a broad relationship, but not for year-to-year changes. The dynamic linkage does not exist.

There are various explanations for this finding. First, there may be no direct causal link between an improved business environment and improved economic performance. Such an explanation is difficult to accept, given the strong prima facie case for the link. However, other efforts to track the impact of changes in the business environment on growth or related indicators have encountered similar problems. The second and more likely explanation is that any causal relationship between the business environment and economic performance is simply difficult to measure at the aggregate level.

FIGURE 5. A COMPARISON OF CHANGES IN AGGREGATE DB AND GCI SCORES



Certainly, any changes in the two sets of indicators are unlikely to march in lockstep over time. The relationship is more complex than a simple "if-then" link. It is also likely that the cumulative effect of changes in the business environment, however measured, matters more for perceived competitiveness than year-to-year changes. The DB indicators offer a mixed bag of legal, judicial, institutional, and administrative elements, some of which are subject to change by a stroke of the pen while others are rooted in legal and cultural traditions. Year-to-year changes are unlikely to capture trends, and the analysis over the longer term is hampered by changes in the methods used (as the World Bank internal evaluation also stressed).

Finally, any direct relationship may be obscured by other factors that affect economic performance. It is remarkable, for instance, that nine of the 12 countries included in our analysis are quite optimistic in terms of their competitiveness, ranking it much higher than the average country for a given DB score. What are the factors that drive this optimism? Or is it simply due to a systematic measurement bias?

Our inability to trace the competitiveness impacts of business environment reform at the aggregate level argues in favor of a bottom-up approach, targeting relationships at the level of individual value chains. As MENA countries embrace business environment reform, they may need to broaden their strategic approach to incorporate this emphasis on the growth of selected value chains. In fact, that is the approach taken in the substantive contributions to the *The Arab World Competitiveness Report 2007*, which focuses on value chains such as information and communications technology and tourism. That orientation could complement the top-down reforms addressed under trade agreements or through the GfD Initiative.

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VIETNAM'S BUSINESS ENVIRONMENT: COMPLYING WITH OBLIGATIONS ABROAD AND COMPETING AT HOME

by Helle Weeke, Steve Parker, and Edmund Malesky

Top-down and bottom-up dynamics in business environment reforms

An economy's business environment is not defined just by the legal and regulatory framework at the national level. Local governments typically play a major role in shaping the actual business climate, both through their own regulatory actions and through their implementation of national-level regulations. And while no change in the national framework can happen without central leadership and commitment, the actual impetus for reform may come from below.[1] The reverse is also true: without adequate implementation at the local level, national reforms can fail to have an impact on competitiveness and economic growth. Strategies linking top-down and bottom-up reforms are therefore critical to any successful initiatives to forge a business enabling environment.

Vietnam's success in connecting these two dimensions—promoting national-level reforms and stimulating competition to improve the business environment at the local level—offers a number of lessons. Two projects funded by the U.S. Agency for International Development (USAID) have played a major role in these efforts. The Support for Trade Acceleration Project (STAR I and II), focusing on the implementation of the U.S.-Vietnam Bilateral Trade Agreement (BTA) and World Trade Organization (WTO) accession, and the Vietnam Competitiveness Initiative (VNCI I and II) have supported regulatory and administrative reforms by the country's institutions at all levels.

One element of that support has been the introduction of the Provincial Competitiveness Index (PCI) as a yardstick for measuring changes in the provinces' business environments. The spring 2006 issue of *Developing Alternatives* (*Breaking the Rules That Bind: Freeing Private Enterprise from the Shackles of Regulation*) reported on initial experiences with the PCI in assessing the impacts of local business environments and stimulating competition among provinces to improve key governance indicators. Since then, VNCI has carried out annual PCI surveys that have become a major factor in promoting business environment reforms at the provincial level.

These local initiatives fit into and contributed to the broader context of legal and regulatory reforms at the national level. Over the past seven years, Vietnam has revamped much of its economic framework, largely in response to requirements to implement the BTA with the United States and then similar but expanded requirements for acceding to the WTO.

Trade obligations drive business environment reforms

Most modern trade accords—in particular, U.S. trade agreements as well as WTO accession agreements or treaties with the European Union—entail extensive requirements that go far beyond the traditional objective of reducing barriers to trade, such as tariff rates and import quotas; instead, they call for developing countries or transition economies to modernize their overall legal and institutional frameworks. To bring rules,

[1] At times, of course, reforms may be triggered by concerns at the sectoral (or value chain) level, where the regulatory and administrative burdens demonstrably and avoidably undermine competitiveness. See the article by Bryanna Millis in this volume.

regulations, and administrative procedures more in line with international best practices requires a country to commit to legislative and regulatory transparency, due process, arms-length regulation applied equally to all firms, administrative review, and formal dispute settlement through arbitration and the courts. Effectively employed, the increasingly transparent and legal representation of commercial, regulatory, and administrative rights and responsibilities benefits both domestic and foreign firms. It improves the country's business environment, strengthens the rule of law, and combats corruption.

Regulatory reform through trade agreements is "top-down": the national government negotiates with foreign countries to develop a trade treaty that is enacted into law for application throughout the economy. In some cases, needed legislation and regulatory reforms must be in place before negotiations are finalized. In other cases, a country promises to phase in reforms over a specified period of time. Either way, effective implementation of the reforms generally takes time, as institutions need to be strengthened for the task.

Trade agreements can give developing countries a useful roadmap for improving their economic competitiveness, as the economy faces increased foreign competition. Policy makers can use that roadmap to improve the business environment and to exert pressure on both the executive and the judiciary to improve their regulatory and dispute resolution capacities. For example, trade agreements typically have strong transparency provisions, requiring that all laws and regulations be published in an accessible state journal before coming into effect and that private stakeholders have the opportunity to be aware of and comment on the drafting of new laws, regulations, and administrative procedures. Transparent legislative, legal, regulatory, and administrative systems are the cornerstone of strong economic governance and rule of law.[2] Transparency can facilitate bottom-up pressure for reforms by businesses and consumer groups. A more transparent legal system enables business groups to exercise their rights and counter arbitrary application of rules.

Expanding trade in services, and encouraging foreign investment in not only primary and manufacturing sectors, but also services, have emerged as key concerns. Improved access to services is a key factor in shaping an economy's competitiveness. Critical service sectors are often subject to the most stringent government regulations because of social and public policy concerns, typically restricting the role of foreign providers. Balancing the need to facilitate the provision of services throughout the economy with adequate safeguards for these concerns poses a serious policy challenge. If trade in services is expanded, this broadens services available to business by opening access for foreign service providers and simulating the development of international standards among local service providers. Trade agreements provide guidelines for applying effective regulation equally and fairly among foreign and domestic firms with adequate opportunity for appeal.

Treaty and trade agreement provisions to encourage and facilitate foreign investment include demands for streamlining the registration process for foreign firms, a process that encourages partner countries to make registration easier for domestic firms as well. These efforts, in turn, can strengthen the corporate governance regime, improve contract enforcement, modernize the financial sector, and enhance procedures to register and protect property rights. U.S. trade agreements in particular also stress improving protection of intellectual property rights, which for their part entail important improvements in judicial procedures.

[2] See also the articles by Delia Rodrigo and Jeffrey Lubbers in this volume.

Fostering national regulatory reforms

In Vietnam, the USAID-funded STAR Project supports national-level reforms agreed to in the BTA, which became effective in December 2001. In January 2007, Vietnam acceded to the WTO. Both the BTA implementation and WTO accession guided a comprehensive process of review and revision of the country's system of commercial laws and judicial procedures, within the context of Vietnamese institutions and traditions. Vietnam revised or developed anew more than 100 laws and regulations in this process. In fact, many of these reforms went far beyond the specific requirements of the trade agreements. Over the past 10 years, Vietnam has shifted its development strategy solidly to promoting a competitive market economy.

In response, economic growth has been strong, as international and domestic trade and investment have boomed (Parker, Phan, and Nguyen 2005). Poverty levels have fallen substantially. Greater integration into international markets, however, has raised new challenges. Vietnam has struggled to manage a major increase in capital inflows following WTO accession. Integration also means that the economy is more exposed to the current global financial crisis and economic downturn.

Advancing bottom-up reforms

USAID's Vietnam Competitiveness Initiative (VNCI) in many respects complements support for national level reforms through STAR. A central focus of this assistance is the Provincial Competitiveness Index. Launched in 2005, the PCI seeks to foster competition among provinces in pursuit of a more hospitable business environment.

The first PCI report was published in 2005 by the Vietnam Chamber of Commerce and Industry (VCCI) and VNCI. That report was the first effort to document the importance of good local economic governance for economic growth and private sector development in Vietnam. It was the subject

The Provincial Competitiveness Index (PCI)

Vietnam's PCI seeks to compare business environments across provinces, based on responses to a detailed mail survey of businesses' perceptions, in combination with available statistics ("hard" data). The survey results and hard data are combined into 10 subindices:

1) Entry costs,
2) Access to land,
3) Transparency and access to information,
4) Time costs of regulatory compliance,
5) Informal charges,
6) State sector bias,
7) Proactivity of provincial leadership,
8) Private sector development policies,
9) Labor training, and
10) Legal institutions.

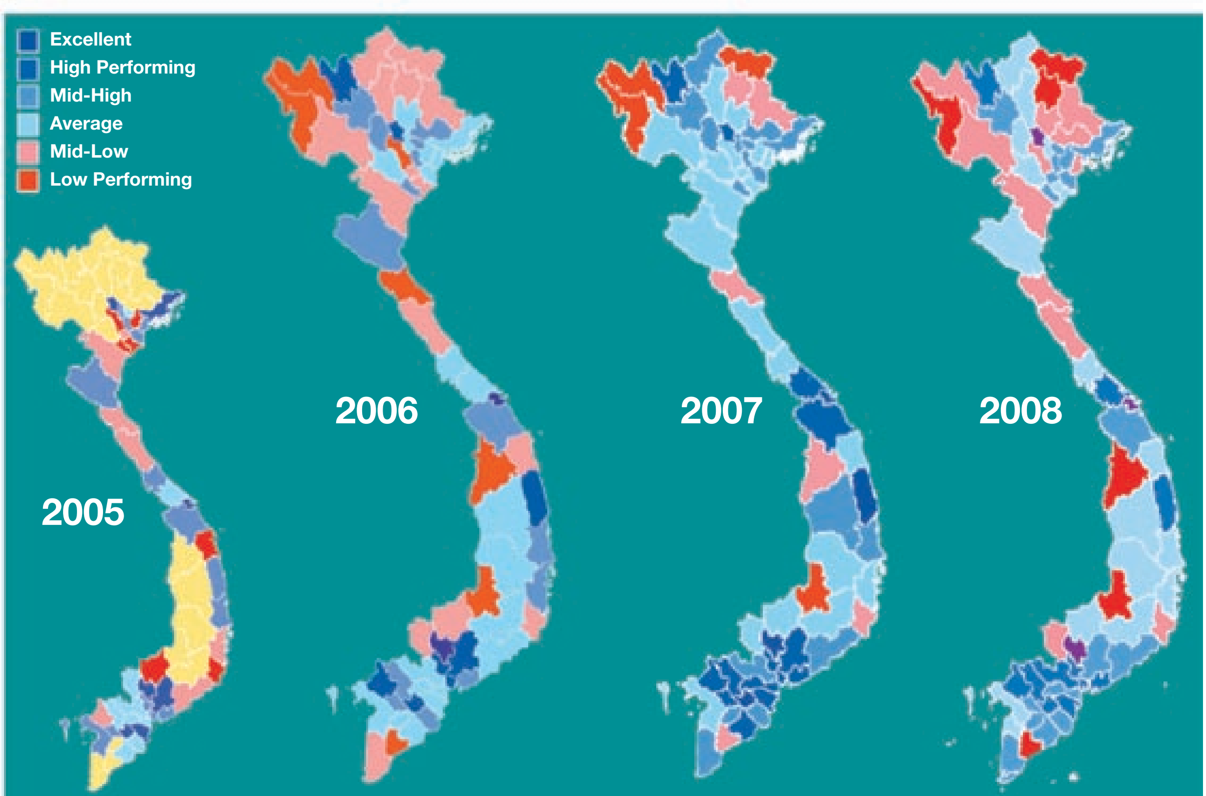
These subindices are then aggregated into an overall PCI using a procedure that assigns weights to each according to their importance in shaping economic performance—investments, profitability, and firm registrations—based on an econometric analysis. To compare provinces on an equal basis, the PCI controls for effects of structural endowments and conditions, such as market size, human and physical capital stocks, infrastructure, and location.

In constructing the PCI, the project team realized that the rankings might be controversial. It therefore paid particular attention to partnering with a strong local organization—the VCCI—and involving local economic research institutes as well as respected economists to develop the questionnaire and check the data.

In 2008, 7,820 firms returned the questionnaire for a response rate of 26 percent, up from 21 percent in 2007. (Actually, after correcting for firms that went out of business or moved, the response rate was over 30 percent.) Since 2006, the PCI has covered all 64 provinces, and the approach has remained stable, which allows comparisons over time.

Vietnam is somewhat unusual in having substantial amounts of economic data available by region (province). Where such data are not available, the approach needs to be adjusted; in these cases, it may not always be possible to disentangle the effects of the business environment, as measured in the PCI, from other factors.

The PCI reports, as well as the survey data, are available at www.pcivietnam.org.



of immense attention from government officials, the public and media. This initial report, as well as subsequent PCI reports (2006, 2007, and 2008), demonstrated that there are important differences in how provincial government officials interact with and support local businesses, and how laws and regulations are being implemented at the provincial level. The PCI also revealed the considerable scope of provincial governments' discretionary authority. Vietnam is nominally a centrally dominated system, but provincial officials have considerable leverage in their implementation of general guidelines. The PCI substantiated a large variance in exercising this discretionary authority, and the impact of local choices for private sector success, suggesting a "governance premium": provinces with higher PCI scores tend to have higher per capita incomes.

The PCI is a tool for measuring and assessing the standards of economic governance in Vietnam's 64 provinces. It incorporated some of the elements of the World Bank/IFC's *Doing Business* indicators, but focused primarily on the perspective of private domestic enterprise. The calculation of the PCI has benefited from the availability of detailed data at the provincial level in Vietnam. Its impact has been boosted by the enormous public response to the release of each annual PCI report. From the outset, immense media attention to the PCI has been an important element in its success. The media have reported on provincial rankings and, in particular, on the responses—both positive and negative—to the PCI from local government officials.

The analysis of the PCI highlights the importance of good economic governance for attracting investment and generating growth, and identifies opportunities for better practices at the provincial level. The PCI methodology has proven to be remarkably robust, consistently identifying top performers among Vietnam's provinces, while allowing room for other provinces to improve and achieve higher PCI scores in subsequent years.

The PCI survey highlights common problems across provinces that *cannot* be resolved at the provincial level. Many of the regulatory requirements that businesses must comply with at the provincial level are imposed by national laws and regulations (laws, decrees, circulars, decisions), as well as by the day-to-day application of those laws and regulations in the provinces. Action at the national level is necessary to overcome these hurdles. Aggregate PCI data[3] show that the significant regulatory burden on businesses seriously impairs their ability to grow, add jobs, and access markets.

Overall, the PCI has gained a strong reputation as a reliable and accurate tool for assessing economic governance. Central and local officials have "internalized" it as a reform tool to focus public consultation procedures and to benchmark progress in economic governance.

Registering progress at the provincial level

Since the release of the first report in 2005, the PCI rankings have encouraged competition among provinces to improve scores, leading many provincial governments to launch initiatives to improve local economic governance. A number of provinces have climbed the "PCI ladder": between 2006 and 2007, for example, the median weighted PCI score rose from 52.4 to 55.6, reflecting gains in economic governance. In 2008, however, it actually dropped to 53.2. The principal causes: private sector development services and labor policy—two of the four most heavily weighted subindices—declined across most provinces, and public service delivery slipped in some provinces. The decline in 2008 may also reflect unmet expectations by firms: the steady improvement in Vietnam's legal and regulatory framework has raised the bar for officials. National-level factors played a role as well. Firms' perceptions are also likely to be connected to macroeconomic instability and subsequent insecurity experienced by private actors at the beginning of 2008. Such changes are not unusual in surveys that reflect perceptions.

The subindex for the time costs of regulatory compliance has worsened over time, largely as a result of higher post-registration costs of regulatory compliance—23 percent of the firms report spending more than 10 percent of their time on bureaucratic procedures. The burden of government inspections, however, declined substantially to the point that they are no longer reported as a significant obstacle to doing business. In contrast, cumbersome paperwork and other procedures in day-to-day interactions with provincial bureaucrats continue to pose problems. In an effort to alleviate the regulatory compliance burden on businesses, the Prime Minister has launched a new program, Project 30, intended to streamline administrative procedures. STAR and VNCI are providing technical assistance and support to implement Project 30.

On the positive side, waiting periods for business registration and procedures for start-up have declined significantly throughout the country, largely attributable to the creation and operation of one-stop shops. Security of property rights has also improved, with 81 percent of PCI respondents holding formal land use right certificates, up from 75 percent in 2007 and 55 percent in 2006. The survey also registered gains in transparency and access to legal documents, largely because of the growing importance of Provincial Gazettes mandated by the 2005 Law on Local Laws. A significant improvement in 2008 was a decline in state-sector bias, which reached a historical low. Only 39 percent of survey respondents reported explicit bias on behalf of state-owned enterprises (SOEs), and more than 50 percent of firms believe that their province has a positive attitude toward

[3] To draw out implications of the PCI survey data for national policy, VNCI developed national aggregates from responses to individual questions in the survey, and weighted them by the provincial portion of the population (see Malesky and Weeke 2007).

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private entrepreneurs. In fact, the number of provincially-managed SOEs has fallen by 60 percent since 2000, largely because of "equitization."[4]

A number of provinces officially made legal commitments to improve PCI scores through official resolutions of the Party Secretary and People's Committee, or adoption of action plans sanctioned by the top leadership. In many cases, these documents go beyond broad statements that call for general improvements: they identify specific provincial weaknesses in economic governance, assign responsibility to individual actors, provide clear targets for measuring success, and identify local initiatives to help achieve those results. Tracking PCI scores over time has shown that the provinces that have achieved the greatest improvements are the ones where local leaders publicly committed to the task of improving scores.

Responding to requests from provincial leaders, VNCI has conducted "PCI Diagnostics" in more than 40 provinces to identify possible improvements in economic governance practices. These diagnostics involve tailored presentations of PCI findings to provincial authorities, representing an exchange of ideas and not technical assistance per se. A number of these provinces have implemented reforms following the diagnostics, and have subsequently recorded gains in PCI scores. For the most part, however, these reforms have targeted "low-hanging fruit," such as making more legal and planning documents available on a provincial website, leading to modest gains in PCI scores. Some provinces decided to take the PCI Diagnostic approach further and requested longer-term technical assistance from VNCI; other donors as well, such as the International Labour Organization and the Danish and Swedish international development agencies, use the PCI in their own technical assistance programs with provincial authorities.

A highly positive trend is that provincial officials are also learning from each other. For example, officials from nearly every province in the country have traveled to Binh Duong, the perennial number one in the PCI rankings, to learn about best practices. One explanation for improvements and convergence among provinces in the Mekong delta has been their willingness to share reform initiatives through visits and consultations.

Reinforcing reforms at the national level

Tackling the time costs of regulatory compliance

The Prime Minister's Master Plan on Administrative Procedures Simplification—Project 30—is designed to reduce the regulatory compliance burden. Implemented with USAID support through VNCI, it will initially inventory all of the administrative procedures affecting firms at both the national and provincial levels, placing the results in a transparent, accessible, and comprehensive database. The inventory will allow a rapid and thorough assessment of the current post-registration regulatory burden faced by firms and will enable firms to reach a better understanding of their rights and obligations. The second phase of Project 30 will review, simplify, or abolish unnecessary, illegal, and cumbersome procedures.

Any achievements by Project 30 can be tracked directly under the PCI subindices of entry costs, land access, transparency of information, time costs of regulatory compliance, and informal charges. Provinces that are diligent in carrying out the inventory and review of administrative procedures in order to cut and simplify the cumbersome paperwork for firms should expect to attain higher PCI scores on key indicators. National median PCI scores should also improve, reflecting nationwide reductions in the regulatory burden.

[4] This is the official English translation of the phrase *co phan hoa*, the process by which shares of SOEs are offered to the public. Centrally managed SOEs, however, may have become more important; some of them are investing all over the country.

Enhancing transparency

The most critical factor in improving the local business environment is the transparency of business information. Statistical analysis suggests that firms tend to expand investment most rapidly when operating in provinces where regulatory information, master plans, and infrastructure maps are most widely available. New legislation in Vietnam aims to expand transparency at both the national and provincial levels. The 2002 Law on the Promulgation of Legal Normative Documents (LNDs)—the Law on Laws—requires publication of all national-level legal documents for 15 days in the Official Gazette before coming into legal effect; revisions in 2008 establish a 60-day public comment periods for LNDs. The 2005 Law on Local Laws requires the establishment of provincial official gazettes. These reforms, supported by the STAR Project, in part were designed to meet BTA and WTO obligations, but also serve to improve transparency and participation for Vietnamese businesses and citizens.

Publication of the provincial gazettes, mandated by the Law on Local Laws, proceeded slowly at first. In April 2006, only nine provinces and national-level cities published provincial gazettes. By June 2008, however, all but one province issued provincial official gazettes in hard copy, and 20 provinces had set up searchable, online gazettes. The mere act of putting gazettes online had a dramatic impact on PCI transparency scores.

Addressing the implementation gap

In 2005, Vietnam adopted two critical new laws: the Enterprise Law, replacing the ground-breaking 2000 Enterprise Law that greatly facilitated business registration, and the Investment Law, which established a uniform set of rules for investment by all businesses, domestic, foreign, or state. The Investment Law vested authority to issue most investment licenses in provincial Departments of Planning and Investment, a significant departure from prior rules, which had required investors to submit applications for investment licenses with the ministry headquarters in Hanoi.

Once implementing regulations were issued, it quickly became clear that execution of these two new laws varied greatly among provinces. To help address the gap in the implementation, as well as other legal documents regulating the business environment, the government included the VCCI on relevant drafting committees. The VCCI also aggressively engaged in a dialogue with provincial authorities to improve implementation.

Setting up one-stop shops

Vietnam's one-stop shops are intended to handle in one office three separate start-up procedures from three different government agencies: the business registration certificate issued by the local Department of Planning and Investment; the tax code issued by the tax authority; and the Seal for stamping documents—the "chop"—issued by the local police department. When one-stop shops for business registration were initially contemplated in the early 2000s, provincial governments were officially obligated to develop new procedures. Guidance from the Ministry of Planning and Investment specifies a maximum waiting period of 15 days for all three procedures.

Localities interpreted these policies differently. Some provinces granted official approval to have the chop made, but still required entrepreneurs to visit provincial police departments to register it after it was manufactured. Others required that a police official work directly in the one-stop shop, so that the chop registration could be granted immediately. Some provinces required separate applications for each document, while others found ways to consolidate the applications.

Eventually, in December 2007, the varying interpretations of the procedures for chop issuance led central officials to take action. The chop license was abolished by the Ministry of Public Security entirely. Now, a firm must only have its chop made at a local establishment and take it to the police for registration, a formality that cannot take longer than two days. With the chop license abolished, new guidance stipulated a maximum waiting period of no more than five days for registration and tax certificates.

Linking bottom-up and top-down action for effective reforms

Combining trade obligations and competition among provinces has led, and is continuing to lead, to an improved business environment in Vietnam. As a "living yardstick," PCI-based monitoring establishes benchmarks and tracks progress. The PCI is being used as a monitoring tool by Vietnamese authorities and various donors to trace improvements in the business environment in provinces where they work. The U.S. Mission uses PCI data as a basis for discussions with provincial leaders and businesses to understand the local business climate and evolutions in economic governance.

Vietnam has astutely combined top-down and bottom-up approaches to regulatory reform. Meeting trade obligations helped to create a more consistent, open, and effective legal environment for business activity. The PCI has provided provincial governments and business stakeholders with a quantitative assessment of problems faced by private businesses at the local level, as well as what policies can be changed to reduce those problems. It has also stimulated improvements in local economic governance through competition among provincial governments. USAID has worked in a highly effective partnership with Vietnamese government authorities and private-sector stakeholders at both the national and local levels. The ultimate beneficiaries have been more productive businesses, workers, and farmers in Vietnam who have been able to become more productive—creating jobs, growing incomes, and reducing poverty.

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REGULATORY TRANSPARENCY: THE TRANSFORMATION OF THE U.S. RULEMAKING PROCESS[1]

by Jeffrey S. Lubbers

The gospel abroad

In this article, I discuss the administrative rulemaking process (see Lubbers 2006a). Don't get me wrong: I am here to praise administrative law, not to bury it. Administrative law is endlessly fascinating, partly because it comes up in such a variety of regulatory settings. Especially in Washington, D.C., it is of crucial importance to practicing lawyers. (I wish I had a dollar for every time a lawyer has told me that he or she regretted not taking administrative law in law school or not paying more attention in the class.) Rulemaking may not be the most glamorous topic, but it involves important issues of good government and numerous useful legal issues for lawyers to invoke in their practices.

Differences in legal traditions pose a major challenge to any effort to strengthen the rule of law in transition economies and developing countries. In recent years, the United States has spread the gospel of notice-and-comment rulemaking—as set forth in Section 553 of the Administrative Procedure Act (APA)—to enhance the transparency of the regulatory process. And it has had some success around the world. The concept of regulatory transparency is enshrined in obligations under the World Trade Organization, and U.S. negotiators have stressed its importance in bilateral free trade agreements. For example, the U.S.-Morocco Free Trade Agreement, which became effective on January 1, 2006, stipulates that each country "shall ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in such a manner as to

The Quest for Regulatory Transparency

Transparency is key to the development of "smart" regulations that support the functioning of sound markets. An effective regulatory impact analysis depends on openness and consultation with the stakeholders affected. Insisting on the transparency of the regulatory process is therefore a basic ingredient of any regulatory reform drive. But there are also competitiveness implications in regulatory transparency.

Suppose Country A's process of administrative rulemaking is fully transparent, with opportunities for all stakeholders to review draft regulations and provide opinions and other inputs. Now, if one of its trading partners employs a closed process in issuing social, environmental, or technical regulations, Country A may find itself at a competitive disadvantage, since its economic agents are likely to be surprised by new regulations from the trading partner. For this reason, a commitment to opening up the regulatory process to consultation forms part of World Trade Organization (WTO) obligations. In negotiating its free trade agreements with countries such as Vietnam or Morocco, for example, the United States has expanded the requirements for regulatory transparency. In fact, WTO commitments or trade agreements can be powerful drivers for regulatory reform.

In many respects, the United States has set the gold standard with its notice-and-comment rulemaking process—and it has promoted these principles through overseas technical assistance and trade negotiations. Jeffrey Lubbers explores key aspects of the U.S. approach, but it is a system in transition. Understanding these trends will help in addressing the move toward a more responsive regulatory process in developing and transition countries. The technical solutions being developed in the United States—and in other Organization for Economic Co-operation and Development (OECD) countries—will provide guidance and tools for opening up the regulatory process elsewhere. In the next article, Delia Rodrigo looks at recent experiences in countries outside the OECD and examines prospects for further improvement.

[1] This article is adapted and updated from an address at Ohio Northern University College of Law as part of the Dean's Lecture Series on February 22, 2007, published as Lubbers 2008.

enable interested persons and the other Party to become acquainted with them" and "[t]o the extent possible, and within its constitutional framework" . . . shall: (a) publish in advance any such measures that it proposes to adopt, and (b) provide interested persons and the other Party a reasonable opportunity to comment on such proposed measures" (U.S.-Morocco Free Trade Agreement, art. 18.1).

Personally, I have been asked by the U.S. Agency for International Development, the World Bank, and the U.S. State Department to participate in law reform activities promoting rulemaking in such diverse places as China, Georgia, Japan, Latvia, Mexico, and Morocco, all with some measure of success (see, for example, Lubbers 2006 and Russell-Einhorn, Lubbers, and Milor 2002).

Ossification at home?

But at the same time we are promoting public participation through rulemaking in far-off places, our own homegrown process is being criticized as "ossified" (see, for example, Pierce 1995 and McGarity 1992), and U.S. agencies are seeking ways to circumvent the increasingly formal "informal" rulemaking process. Is there any truth to the assertion that agencies are shying away from the notice-and-comment rulemaking process? There is certainly a lot of anecdotal evidence, if you talk to agency lawyers. Moreover, the number of court cases challenging agency regulatory letters, opinions letters, guidance, and other supposedly nonregulatory policy statements has markedly increased.

Administrative rulemaking is certainly not a new phenomenon. As Jerry Mashaw explained in his fascinating study of administrative law in the first few years of U.S. history,[2] the very first Congress delegated rulemaking authority to the executive branch. By an act of September 29, 1789, Congress assumed responsibility for the payment of the pensions to disabled Revolutionary War veterans that had originally been paid by the states. The statute—one sentence long—provides simply that pensions should be paid "to the invalids who were wounded and disabled during the late war . . . under such regulations as the President of the United States may direct" (U.S. Congress 1789).

Nevertheless, more than 100 years later, in one of the earliest administrative law treatises, Frank Goodnow cautioned, "The extent to which the administrative law of the national government is to be found in executive regulations is not ordinarily appreciated" (Goodnow 1905, 87). Things had changed by 1970, when the author of the most famous and influential treatise in administrative law, Kenneth Culp Davis (my administrative law professor) wrote that "The procedure of administrative rule making is one of the greatest inventions of modern government" (Davis 1970, sec. 6.15). But contrast this with a recent comment by another keen observer of the rulemaking process, Stephen Johnson of Mercer Law School: "Over the past few decades, Congress, the courts, and the executive branch have layered so many significant procedural requirements on notice and comment rulemaking that most academics and policymakers agree that the process has become ossified and inefficient" (Mercer 2006, 61).

At first blush, though, agencies seem to be doing as much rulemaking as ever, at least if you count the number of pages in the *Federal Register*. By this measure, federal agencies have been busy in the Bush Administration. According to statistics compiled by the Competitive Enterprise Institute (CEI), from 2003 to 2005 the *Federal Register* ran between roughly 75,800 and 78,800 pages, and in 2002 it reached 80,332 pages (Crews 2006, 27–28). There have been only two years in the history of the *Federal Register* in which it

[2] Mashaw 2006; see also his sequel (Mashaw 2007) discussing administrative law in the period 1801–1829.

was larger: 2000 (83,294) and 1980 (87,012, the all-time record).[3] Indeed, during President George W. Bush's first term, there were more *Federal Register* pages than in any other presidential term, and the total pages from 2004 to 2006 exceeded the total for any other three-year period in the nation's history.

The pace of rulemaking is slackening

Of course, the number of pages is a very rough proxy. It does not really measure the number of rulemakings—rather, it seems to reflect the increasingly long preambles to both proposed and final rules. In fact, the number of actual proposed and final rules suggests a *decline* in notice-and-comment rulemakings. Using the CEI's statistics, the high-water mark in both proposed and final rules was in 1979 under the Carter Administration: 7,611 final and 5,824 proposed rules. Even in 1983, in the middle of the anti-regulation Reagan Administration, there were 6,049 final and 3,907 proposed rules. But in 2005 (the most recent year of CEI's data), rulemaking reached the lowest point covered by CEI's data: just 3,943 final rules and 2,257 proposed rules. This means that the government was publishing 48 percent fewer final rules and 61 percent fewer proposed rules than in 1979, and even 34 percent fewer final rules and 42 percent fewer proposed rules than under the Reagan Administration in 1983.

This precipitous drop in final rules published in the *Federal Register*—and the even more dramatic drop in proposed rules published for comment—clearly show the ossification of rulemaking, or at least increased agency reluctance to use the APA's rulemaking process. What accounts for this trend? Like Stephen Johnson, I think the causes can be laid at the feet of all three government branches—Congress, the President, and the courts.

More complex legislative requirements

Congress has enacted several important statutes that have made rulemaking more complicated, both procedurally and analytically. First, it enacted "hybrid rulemaking" provisions with additional oral hearing procedures in statutes governing major health and safety agencies such as the Consumer Product Safety Commission, the Environmental Protection Agency (EPA), the Federal Trade Commission, and the Occupational Safety and Health Administration (OSHA), mostly in the 1970s. After much criticism,[4] Congress stopped pressing for such requirements, but these laws are still on the books.

Second, it enacted new analytical requirements modeled on the environmental impact statements (EISs) originating in the 1970 National Environmental Policy Act. This law, of course, was hailed by environmentalists and other pro-regulatory forces, and was used extensively to slow down development that might harm the environment, but the EIS mandates spawned other impact analysis requirements that were primarily promoted by business groups and others skeptical of regulation.

One such requirement was contained in the Paperwork Reduction Act of 1980, an act that not only created the Office of Information and Regulatory Affairs (OIRA) in the White House's Office of Management and Budget (OMB) but gave it the authority to review forms, questionnaires, and the paperwork impact of rules that contain reporting requirements—even those rules issued by independent regulatory agencies. In the same year, the Regulatory Flexibility Act required agencies to analyze the impact of proposed and final rules on small businesses and small towns, and to analyze alternative approaches to the rule as well. This law was markedly strengthened in 1996 by the Small Business Regulatory

[3] Both of these were the final year of an outgoing administration, when imminent departure concentrates the mind (see, for example, Cochran 2001)

[4] See, for example, Administrative Conference of the U.S. (1973), urging "that statutory requirements going beyond those of section 553 should not be imposed in absence of special reasons for doing so."

Enforcement Fairness Act (SBREFA), which subjected these requirements to judicial review and added a new layer of review panels for OSHA and EPA rules affecting small businesses.

A year earlier, in 1995, Congress had enacted the Unfunded Mandates Reform Act, which requires agencies to do special assessments where proposed and final rules have an impact on state and local governments, and (due to a last-minute, non-germane amendment) where the rule has a major impact on the private sector. For now at least, however, this law lacks a strong judicial review provision.

Another part of SBREFA, the so-called Congressional Review Act, also requires agencies to send all their rules over to Congress. If these rules are major, agencies must delay the effective date for 60 days to give Congress a chance to pass a joint resolution of disapproval, using procedures that avoid filibusters. To keep this procedure constitutional, the joint resolution requires a presidential signature; accordingly, the process has been successfully used only once, when an OSHA rule issued in the last days of the Clinton Administration was disapproved by the Republican Congress and the disapproval was signed by the newly inaugurated President Bush.[5] This unusual alignment is about to recur in 2009, when some Bush Administration "midnight" rules must face a Democratic President and Congress.

And last, the little-known Information Quality Act (IQA) of 2000—an undebated amendment of the Paperwork Reduction Act inserted into an omnibus appropriations bill—requires agencies to issue guidelines, with OMB oversight, to ensure and maximize the quality, objectivity, utility, and integrity of information disseminated by the agency. Agencies must also establish administrative mechanisms allowing affected persons to seek and obtain correction of such information. The IQA does not, by its terms, specifically apply to rulemaking, but OMB has taken the position that it applies to any information an agency cites in its notice of proposed rulemaking because the agency is thereby endorsing the reliability of that information.

Executive spiderwebs

Compounding this list of statutory accretions to Section 553 of the APA are various presidential additions. The most important: Executive Order 12,866, which established the most recent in a series of rulemaking-review programs that—along with the Paperwork Reduction Act—have made OMB/OIRA the center of the rulemaking universe. By now, OMB review and the attendant need to do cost-benefit analysis for major ("economically significant") rules with a $100 million impact on the economy are such fixtures that any President would want to keep them.

It is hard to criticize the idea of presidential supervision of agency rulemaking. Even Judge Patricia Wald, a staunch liberal, extolled its virtues in her *Sierra Club v. Costle* decision (U.S. Court of Appeals for the District Court of Columbia 1981). However, although the Clinton Administration added a good deal of needed selectivity and transparency to the process, it does lead to delays; its cost-benefit analyses are expensive to produce; and—as a recent study has shown—it probably leads to an over-emphasis on burden reduction at the expense of stronger protection of human health and the environment. Two scholars recently interviewed 30 of the 34 surviving presidential appointees to the EPA from the first Bush and both Clinton administrations: 71.5 percent of those interviewed said it was rarely or never true that the White House sought changes that would make a regulation more protective of human health and the environment, but 89.3 percent said it was often or always true that the White House sought changes that would make a regulation less burdensome for regulated entities (see Bressman and Vandenbergh 2006, 73, n. 141).

5 The rule was a controversial set of ergonomics regulations, issued after 10 years of development by OSHA, addressing the concerns that surround repetitive lifting and motions in the workplace.

OMB review is not going away any time soon, despite its impact on the rulemaking process. A recent amendment by President Bush has added new potential impacts as well.[6] But this is not the end of presidential mandates in the rulemaking process. There are eight other extant executive orders that require extra analyses or assessments:

1) Federalism: requires agencies to consult with state and local governments and consider impacts of rulemakings on them.
2) Indian tribal governments: requires agencies to consult with Indian tribes and consider impacts of rulemakings on them.
3) Civil justice reform: requires agencies to comply with requirements to improve rulemaking drafting to reduce needless litigation.
4) Governmental actions interfering with property rights: agencies should avoid improper "takings" of private property.
5) Federal actions to address environmental justice in minority populations and low-income populations.
6) Protection of children from environmental health and safety risks.
7) Implementation of the North American Free Trade Agreement: requires agencies to provide a 75-day comment period for any proposed technical regulation.
8) Regulations affecting energy supply, distribution, or use.

Like the statutes mentioned earlier, it is difficult to criticize any one of these executive orders individually. They all represent considerations that could be important in certain rulemakings. But to force agencies to do special analyses for all these matters has a cumulative effect not unlike barnacles on a ship. A few will have a negligible effect, but as they multiply, the ship begins to slow down.

And now OMB has begun to issue numerous bulletins with even more requirements affecting the rulemaking process. Its "Final Information Quality Bulletin for Peer Review" (Office of Management and Budget 2004a) requires all agencies to conduct a "peer review of scientific information disseminations that contain findings or conclusions that represent the official position of one or more agencies of the federal government." This bulletin and the "Updated Principles for Risk Analysis" (Dudley and Hays 2007), originally issued as a more sweeping proposed bulletin, place greater procedural and analytical requirements on agency rulemakings involving scientific issues.

To quote an Ethiopian proverb: "When spiderwebs unite, they can tie up a lion." So it is not so surprising, perhaps, that agencies are resorting to issuing "non-rule rules," using various forms of "guidance" in order to avoid some of these spiderwebs. In turn, OMB reacted to this tendency toward circumvention by issuing a bulletin in 2007 on good guidance practices (Office of Management and Budget 2007). Many of the prescriptions of this bulletin are sensible approaches to the abuse of the policy statement exemption from notice-and-comment rulemaking, but on the same day OMB amended Executive Order 12,866 to require that "significant guidance documents" be submitted for OMB review, thus arguably making it more difficult for agencies to offer any form of important guidance.[7]

"Hard look" and the role of courts

So far I have not even mentioned the role of judicial review and the "hard look" doctrine in making agencies even more cautious and verbose in developing their rulemaking preambles. In its decision in the *State Farm* case (U.S. Supreme Court 1983), the Supreme Court overturned an

[6] It requires that OIRA review "significant" guidance; that agencies identify specific market failure before regulating; that the Regulatory Policy Officer appointed under the original order be a presidential appointee; that this officer must approve the agency's annual regulatory plan; that no rulemaking may commence without being on the plan; that the plan aggregate costs and benefits for all rules; and, most curiously, that "formal" ("on the record") rulemaking be considered for "complex determinations."

[7] See "Regulatory Planning and Review . . ." (2007), which adds a new § 9 to Executive Order No. 12,866 on review of significant guidance documents.

agency attempt to repeal a rule, using a form of arbitrariness review that came to be known as the "hard look" test. While the test has been defended as a way to ensure rationality in rulemaking, critics have contended that it has contributed heavily to ossification—similar to the judicial practice of procedural review the Court outlawed in its *Vermont Yankee* decision.[8]

Ways out?

How did we come to this pass, and is there any way out?

One way out may be through perhaps the most influential tool ever developed—the internet—which is being used to institute electronic rulemaking, or "e-rulemaking."[9] The titles of two pieces by experts on e-rulemaking show the two main points of view on this development. One is "The Electronic Revolution in Rulemaking" (Noveck 2004); the other, *The Internet Still Might (but Probably Won't) Change Everything: Stakeholder Views on the Future of Electronic Rulemaking* (Shulman 2004).

I am cautiously optimistic that the e-rulemaking revolution will lead not only to a better-informed public but also to a more user-friendly process for all of us. Already, e-rulemaking has democratized the process by making it possible for the average person to access all the important documents relating to a rulemaking with the click of a mouse. Until 10 years ago, one needed to hire a Washington law firm to go down to the agency docket room and read the printed documents, but no longer. This development may not be the most beneficial for Washington lawyers, but from the standpoint of the general public it could be a great boon. As the federal government's centralized rulemaking portal (*www.regulations.gov*) improves, it should become easier and more efficient for commenters to comment. Ten years from now, paper comments to agencies in rulemaking will likely be as rare as a first-class letter in our own mailboxes.

But these developments invite risks alongside the obvious benefits. Will agencies be inundated with "notice-and-spam" (Noveck 2004, 441)? Will technology for sorting comments by type and subject lead to an arms race between well-financed computer-generated comment machines on the one hand and computer-aided comment sorters in the agencies on the other?[10] Already, congressional offices are employing techniques to ward off unwanted out-of-district emails. Might this spread to agencies as well?

Moreover, e-rulemaking will also bring with it a host of legal and technical challenges, some of which I have written about in my book (Lubbers 2006, 217–239). On the technical side, the following challenges merit our consideration:

Access issues: We must provide public access to every meaningful step in the generation of a rule—from the statute enacted by Congress that authorizes the rule, to the earliest agency action (perhaps an "advance notice of proposed rulemaking"), to the last step in the process—whether it be the final rule, a decision in a court challenge, or later agency amendments, interpretations, guidelines, or enforcement actions. In addition to this chronological view, the public should be given a "vertical" view of pending or final rules—what might be called "drilling down" into the meaningful agency and outside studies and analyses that are now found in the docket, and through links to those secondary studies and analyses referenced in the primary studies.

8 U.S. Supreme Court 1978. See Verkuil 1981 (suggesting that the Supreme Court put the brakes on the hard look doctrine) and Pierce 2005 (renewing this suggestion).

9 For a succinct history of the "rise of e-rulemaking," see Coglianese 2004, 363-366. Links to some of these and many other related papers and studies are available on the website of the Harvard University's John F. Kennedy School's Regulatory Policy Program (http://tinyurl.com/6w5ao3).

10 For a technical paper describing promising techniques for sorting comments, see Yang, Callen, and Shulman 2006.

Docketing issues: Agencies are now faced with the need to develop a strategy for handling a combination of electronic and paper comments. At a minimum, agencies will need to provide a single list of all comments, whether filed electronically or in paper format.[11]

Legal issues: First, there may be problems with archiving requirements.[12] (National Archives and Records Administration 2004). Must (redundant) paper copies be kept due to federal archiving requirements? How about cover emails? Second, we also need to consider attachments. How should exhibits, forms, and photographs be dealt with? Attachments can pose a risk of viruses and of overloading systems. Electronic technology makes it all too easy for commenters to "dump" huge files or a long series of links into their electronic comments.

Third, there are knotty copyright concerns. As public comments have been transformed from easily controlled physical files in Washington, D.C., to internet-accessible digitized documents, copyright issues have suddenly become much more important—both where the submitter is the copyright holder and where the submitter uses someone else's copyrighted work without permission. The former situation seems to be relatively unproblematic because the government can take the position that "submittal of one's own copyrighted material comes with an implied grant that it may use these materials in its internal deliberations" (Brandon and Carlitz 2002, 1472). The submission of another person's material raises more difficult issues. Various technological fixes have been suggested, such as software controls that would code documents so that downloading and copying can be regulated (as is now being done with digital music and films). Professor Noveck suggests that a "simple innovation is to amend the comment interface to allow the user to designate an attachment as nonpublic (confidential business information) or critical infrastructure information by means of a drop-down menu. Once designated, that data could be encrypted and transmitted to the relevant official but not made available to the public" (Noveck 2004, 487).

Fourth, we need to look at security issues. In a post-9/11 world, we must be sure both to prevent unauthorized tampering and ensure that sensitive information is not made available to potential terrorists. Fifth, we must concern ourselves with privacy issues. Should anonymous comments be permitted? Should commenters be identified, or at least searchable by name? Sixth, censorship issues may also present a problem. Can agencies "sanitize" or use the phrase "expletive deleted" in order to clean up obscene comments? Finally, can the government begin mandating e-comments? What legal impediments prevent agencies from requiring e-comments to the exclusion of paper comments?

Moreover, if we are really trying to achieve enhanced participation, can we meet the goal of organizing real-time chat rooms or negotiated rulemakings? What rules should govern these real-time rulemaking discussions? A lot of the issues noted above are magnified in informal, spontaneous discussions that occur in chat rooms, where civility can be in short supply.

The potential politicization of the process

Let me conclude with some commentary on the impact of e-rulemaking on the rulemaking process itself. First, the flip side of increased public participation, of course, is increased responsibilities on agencies to digest and react to a higher

[11] In this connection, the federal government has developed a single electronic rulemaking docket known as the Federal Docket Management System (FDMS). While the OMB intended to complete department and agency migration to the FDMS by September 2005 (Office of Management and Budget 2004b, 20), the process was not concluded until January 2008. See Office of Management and Budget 2008 (end of first bullet under "Progress to date").

[12] The National Archives and Records Administration is responsible for overseeing the archival aspects of e-government. See the most recent annual reports on implementation of the E-Government Act of 2002 (FY 2006–2008) at http:// tinyurl.com/84chhe.

volume of comments. Blizzards of comments have become increasingly common in controversial rulemakings, and e-rulemaking will only accelerate a trend that could lead to "information overload" and also, perhaps, a general politicization of the rulemaking process. We may be inadvertently moving away from the technocratic model of rulemaking—where the substance of the comment is more important than who submitted it or how many times it was repeated—toward a referendum-like system.

Moreover, increased politicization of rulemaking due to new technology has the potential for even greater White House control of the process. Professor Peter Strauss has suggested that not only is OMB playing a central role in "creating this new apparatus," but "to have all information travel through [its] gateway only adds to the possibilities of [its] influence. . . . As agencies become more transparent, they become more transparent to the President as well as to the public. . . . Now the docket is immediately available on equal and easy terms to all who want it, including the President, and politics will give him the incentive to attend to it."[13] This potentially profound development deserves more debate.

As a bottom line, I suggest that as professionals interested in good government, we should have two primary goals in mind: 1) reducing ossification in rulemaking and 2) optimizing the potential of e-rulemaking to increase public access to information and enhance public participation and online "deliberative democracy" (Schlosberg, Zavestoski, and Shulman 2007).

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PUBLIC CONSULTATION FOR MORE TRANSPARENT RULEMAKING: TRANSFERRING PRACTICES FROM OECD COUNTRIES TO THE DEVELOPING WORLD

by Delia Rodrigo[1]

Introduction

The proliferation of laws and regulations, ostensibly designed to promote and protect broader social objectives, can impose a significant burden on the competitiveness of an economy. Transparency of the rule-making process, subjecting proposed laws and regulations to public scrutiny through consultation with stakeholders, represents the key option to balance social objectives and economic costs. There is a growing consensus that transparency "increases the efficiency in the allocation of resources, and it also may help in ensuring that the benefits of growth are redistributed and not captured by the elite" (Bellver and Kaufmann 2005, 2).

Most countries use some form of consultation in their regulatory process, but its application varies considerably around the world. A number of countries in the Organisation for Economic Co-operation and Development (OECD) have developed sophisticated techniques to include stakeholders' views when preparing regulations. Yet many developing countries still lack formal consultation procedures that bring clarity, certitude, and transparency to the rulemaking process.

Ensuring transparency through an institutional process of consultation is not an easy task, but it is key for producing better regulations that attain social and economic objectives while improving the business environment and the rulemaking process. This paper explores some of the basic rationale for consultation, describes techniques that can be used, and gives several examples of countries that face challenges in improving their consultation procedures. It also addresses the transfer of best practices of consultation from OECD countries, including in particular linkages to regulatory impact analysis (RIA).

Consultation in the regulatory process: strengthening transparency

The process of consultation reflects the way that state and society interact in a practical sense. Asking stakeholders for comments involves them in the rulemaking process, enriching discussions about advantages and disadvantages of proposed regulations. In turn, government authorities are held more accountable by citizens or affected groups. Consultation, however, is not a substitute for the democratic legitimacy that elected representatives have in decision making. Rather, it complements the concept of representative democracy by giving affected groups a voice, not a vote. Consultation increases the effectiveness and efficiency of regulations, helping to reduce regulatory risk. Through the process of consultation, regulators:

- can better balance opposing interests, lessening the likelihood that regulations will be challenged or disputed;
- can identify unintended effects of proposed regulation, helping them to avoid imposing undesirable burdens or unnecessary formalities;

[1] This article is inspired by work done both at the OECD and at the Foreign Investment Advisory Service (FIAS), a joint facility of the International Finance Corporation and the World Bank. It represents only the views of the author.

- may find it easier to enforce regulations, as businesses and civil society are readier to comply with laws and regulations that have been subject to consultation; and
- can improve their proposals by making them more technically viable and practically workable.

These arguments present a strong prima facie case for the effectiveness of a formal consultative process as part of the review of existing or new rules. However, providing empirical evidence for the argument that consultation improves the quality of regulations is difficult. For example, the OECD Indicators of Regulatory Management Systems capture the way consultation is undertaken, but do not address the outcomes and impacts of consultation procedures in regulatory decisions. A 2008 discussion of the OECD Indicators suggests that "consultation on new regulations has become routine practice among OECD countries, but methods have changed since 1998."[2]

The same also holds for the EU Indicators for Regulatory Quality, which include consultation among the tools needed to improve the quality of regulation. In an assessment, Radaelli and De Francesco note that quality can be achieved only "when better regulation tools change the way regulators think about public policy, inform ministerial decisions, and conversely, when they change the way organized interests, firms and citizens engage in the policy-making process, understand and accept the regulatory framework" (2004, 4).

Consultation complements other regulatory tools, such as RIA, implementation of the Standard Cost Model (SCM), or review of regulations to address both the stock of existing regulations and the flow of new ones.

Rulemaking and consultation: main techniques

No fixed rules exist for consultation processes. Governments establish consultation procedures based on administrative traditions, political constraints, the complexity of regulatory proposals, and their specific priorities, needs, and objectives. Techniques range from a one-stage approach to a more comprehensive and continuing process that guides the drafting and enforcement of regulations.

Effective consultation procedures require a high degree of coordination among the stakeholders involved at different stages of the rulemaking process. All necessary information about the proposals should reach the relevant groups, and sufficient time should be allocated for the public to consider and respond to the regulatory proposals.

Effective consultation mechanisms require hard work throughout the whole process. Objectives must be clearly defined, along with a structured path on how to achieve them and the techniques and instruments to be used. Selecting actors to participate is essential: public authorities need to be aware of the involvement expected from them.

The most common techniques for consultation found in OECD countries can be grouped in the following categories:

- **Informal consultation:** a discretionary and ad hoc type of contact between regulators and interested groups. It has the advantage of being usable at any stage of the regulatory process, to speed the gathering of information and to involve a wide range of actors. Because procedures are not standardized, though, it can be seen as lacking transparency and accountability.

[2] "There is, for example, considerable variability in the number of days that countries routinely permit for consultation on a new regulatory proposal. While a longer period obviously allows more time for comments, there are diminishing returns to protracted consultation periods. In general a minimum ninety day period of consultation with stakeholders external to government appears to represent good practice. Clearly, there is no ideal period for all proposals and a case by case approach is often warranted" (OECD 2008, 4).

- **Notification:** a one-way process in which information about regulatory proposals is given to the public through publications or wide-distribution channels such as the internet.

- **Circulation for comments:** a more systematized way to reach affected groups and encourage their participation. It can be used at all stages of the regulatory process, though there must be some legal basis for doing so. Different interested groups can be included in this type of consultation, but who is selected depends on the regulator's discretion. It is therefore problematic for weak groups that might be excluded from the consultation.

- **Public notice-and-comment:** a formal procedure, open to all interested parties. It consists of making people aware of the regulatory proposal by publishing it and inviting them to comment on it. This procedure allows more scrutiny of regulation, particularly when it is used for lower-level regulations that do not reach debates in parliament.

- **Public hearing:** a public meeting at which interested parties can comment in person. Hearings are single events, which limits their capacity to reach a broad range of interested groups. In order to be effective, they require coordination and clear guidance on how they should be conducted.

- **Advisory bodies:** an institutional set-up that seems to be one of the most widely used to conduct consultation. At different stages of the regulatory process, advisory bodies help define positions and options as well as gather information. They differ greatly in mandate, status, composition, and other elements, but they are all able to create relevant input to inform final decisions. These bodies can be technically oriented, comprising technical experts on a given subject, or can act to create consensus and negotiate positions.

- **Business test panels:** used to ask business representatives directly about the expected impacts of proposed regulation. Inputs received are made public by the concerned ministry and serve to influence the design of regulations.

Most governments use a mix of these techniques. International experience suggests that consultation procedures are more successful when they open up different channels for public participation with clear and consistent rules that reduce discretion.

All approaches require:

- Organizing participation—selecting the stakeholders and ensuring the credibility of the process.
- Structuring the process—setting up logistics, staff, the nature and rhythm of the consultation, and so on.

Most importantly, the government must use an effective communication strategy, because stakeholders will participate only if they receive the message and if they feel their voices will be heard.

Improving regulatory proposals: consultation as an integral part of RIA

Many countries have adopted RIA to assess different policy options available before government agencies prepare regulations. RIA helps policy makers arrive at decisions based on empirical evidence rather than mere assumptions. It requires an examination of selected potential impacts arising from government action. By asking the right questions in a structured format to support a more transparent policy debate, RIA also serves to communicate information to decision makers and stakeholders.

An effective RIA process demands consultation, because consultation offers the possibility to collect data about the unintended effects of possible regulation. Integrating consultation into the RIA process gives citizens the opportunity to scrutinize the government's preliminary policy analysis and assess the policy options under consideration. However, consultation should focus on the most significant issues with respect to the scope and intensity of the impacts and the risks they pose.

Engaging stakeholders in this process is key to success. Consultation should therefore be targeted at the real stakeholders, encouraging participation by providing clear and concise information, with adequate explanations for technicalities. Targeting, however, should never mean exclusion: a representative group of stakeholders reduces the risk of reinforcing vested interests. Finally, sustaining the dialogue over time is important to engaging stakeholders and gaining credibility. All three of these features—focusing on significant issues, targeting those primarily affected, and sustaining the dialogue—are needed to hold the burden of consultation to a minimum and to keep the interest and motivation of interested groups.

In an attempt to improve the RIA process, a number of countries have revised their consultation procedures. Several of them have sought to better orient policy makers when considering, designing, and executing consultation processes, by publishing guidelines on consultation. These guidelines address several objectives: to foster the use of the consultation mechanism, to harmonize the different procedures used to consult with interested parties, to lay out key principles, and to set minimum standards for consultation procedures.[3]

Disseminating good practices: what is needed?

Consultation is a tool to improve the way regulations are prepared, which in turn shapes the investment climate of any country.[4] It encourages greater transparency, most needed in emerging and developing countries:

- to reduce regulatory risk and failure, so common where institutional capacities are limited and where optimization in the use of resources must be sought and encouraged;
- to improve the decision-making process by having better information to use in selecting among different policy options, and by rationalizing this process;
- to improve the business environment by reducing costs of doing business, building transparency into the regulatory process, and increasing the capacity to attract foreign investment needed for economic growth and job creation;
- to encourage civil participation and bottom-up approaches to regulatory action, in which businesses share responsibilities for promoting regulatory quality and contributing to the enforcement of regulations; and
- to discourage government opacity and corruption, making civil servants and politicians accountable for their decisions.

However, it is not easy to persuade emerging and developing countries to break with traditions and procedures growing from years of state capture, predatory leadership, and arbitrary decision making, and it is unrealistic to expect wholesale change at once. Nonetheless, small steps can help lay a foundation for further improvements.

3 For instance, in 2007, the U.K.'s Better Regulation Executive carried out a review of the consultation process in the United Kingdom. As a result, it published a *Code of Practice on Consultation* (Better Regulation Executive 2008) that sets out the government's policy on formal consultation exercises. Among the countries that have published guidelines on consultation are Ireland (Department of the Taoiseach 2005a, 2005b), New Zealand (Quality of Regulation Team 2006), and Canada (Treasury Board of Canada Secretariat 2007). Finally, the European Union has prepared a paper on consultation to help reinforce the culture of consultation and dialogue in the EU, seeing the document as contributing to its Action Plan for Better Regulation and its new approach to impact assessment (Commission of the European Communities 2002, 3).

4 Policy making to address important governance issues—in particular, the reduction of regulatory risks—is linked to improving the investment climate in several ways, including restraining rent seeking, establishing credibility, fostering public trust and legitimacy, and ensuring that policy responses reflect a good policy fit (see World Bank 2004).

Consultation in rulemaking: some key steps

1. Strengthening consultation at the highest political level

A country's first step—to encourage the use of consultation—may be one of the most challenging, but it can bring out into the open an often strong resistance from vested interests, from ministries, and sometimes from above the ministry level, as well as from influential business and other stakeholders. Only real political commitment to fight this resistance and impose new rules of the game can overcome this initial barrier.

Example: the Dominican Republic

In the framework of the National Competitiveness Program, the Government of the Dominican Republic established the National Competitiveness Council (NCC) in 2001 to oversee the public-private dialogue needed to design and implement policies to increase the competitiveness of the country's economy. The NCC was ratified by law in 2006.

Among its tasks, the NCC was charged with creating a space for consulting with the relevant stakeholders in the country about what actions, strategies, and policies were needed to improve the business environment. It has played a coordinating role in moving forward with administrative and regulatory changes in the Dominican economy.

Some of the lessons learned from the NCC's effort (Consejo Nacional de Competitividad 2008):

- Leadership at all political levels is needed to speed up reforms;
- Public-private dialogue is key in launching comprehensive reforms and sharing responsibilities; and
- An independent institution can be a good forum for promoting dialogue between government agencies and stakeholders, helping to build trust and partnerships.

2. Building stakeholders' capacities for consultation

Building stakeholder capacities will bring significant benefits to the regulatory process in the long term. Consultation works best where stakeholders are empowered, knowledgeable, and focused, with appropriate agreed "rules of engagement" and appropriate information and resources. Training targeted to the needs of key stakeholder groups can demonstrate the benefits of engaging in consultation processes. In cases where there is clear maturity and openness, delegating functions to stakeholders should be encouraged.

Example: Jordan

Like most countries of the Middle East and North Africa (MENA) region, Jordan faces a governance gap that undermines its business environment. Although the country has attracted private investment through a vast privatization process, the business environment still imposes risks, delays, and heavy transaction costs.

One of the elements that has been identified as essential for Jordan's competitiveness is to improve the regulatory environment to eliminate and streamline regulations that limit the growth of the private sector. Engaging with stakeholders, and institutionalizing an open and public consultation process between the government and the private sector during the decision making, are fundamental (World Bank 2003).

USAID's Sustainable Achievement of Business Expansion and Quality (SABEQ) Program in Jordan has conducted individual training for government officials on consultation to raise awareness about the need to formalize consultation procedures and present international good practices (see http://www.sabeq-jordan.org/).

3. Introducing consultation procedures over time

The consultation process must be built over time. Having a legal framework for consultation procedures is appropriate, but consultations have to be seen as a natural part of the process and not only as an obligation. Implementation is, in most cases, the real challenge. But as in many policy areas, consultation is learned by doing.

Example: Chile

Public consultation has not been traditionally used in public administration in Chile; however, recent efforts to enhance the relation between regulators and the regulated have proved particularly successful. Two stages can be distinguished:

- In 1999, a Public-Private Committee (PPC) was established as a reaction to the economic crisis that especially affected small and medium-sized enterprises (SMEs). The PPC sought to provide technical and advisory support to the executive government in the promotion of the private sector. This co-operation included work on a regulatory dimension, giving rise to a number of legal proposals aimed at improving the regulatory environment for SMEs, prepared by teams of government officials and private sector representatives.

- In 2003, with the economic crisis past but economic growth still floundering, more attention was given to large enterprises and how they could contribute to the Chilean economy through higher growth rates. A pro-growth agenda, which included regulatory reform aspects, was defined in close cooperation with key actors in the Chilean economy.

The PPC has been successful in improving the way government understands the challenges faced by the private sector. As a key outcome of close public-private dialogue, a milestone reform took place in 2008 with the adoption of the new statute for SMEs that defines a new regulatory framework to promote positive discrimination in favor of SMEs. In 2009, this statute is to be passed in Congress. There are still discussions on the best way to improve regulations originally designed for large corporations.

These healthy consultation processes were open to the business community. However, other representatives of civil society, such as labor unions, were participating in other forums that had a less visible outcome and fewer resources to operate with, or only addressed regulatory issues dealt with by Congress. To promote participation in executive regulatory management, the government has announced plans to improve consultation in coming years.

4. Including consultation in the preparation of regulations

In countries where the rulemaking process has traditionally been closed to the public, any reforms require several elements. Government officials have to be trained to conduct high-quality consultations; a consultative process needs to be allocated adequate time and resources; stakeholders require incentives to be organized and must then actively participate; and the whole consultation process has to be managed in a systematic way.

Example: China

Consultation has been gradually integrated into the rulemaking process in China. The Legislation Law, adopted in 2000, included procedural allowances for consultations that support transparency. Some of the techniques adopted for consultation are panel discussions, feasibility studies, or meetings and hearings. But the law does not provide a clear definition of the "concerned constituencies" whose opinions can be heard. Moreover, though progress has been observed in the process of preparing regulations, consultations are not mandatory.

The speed of China's economic development has imposed serious demands on the government's regulatory capacity; greater transparency in the regulatory process was one of the most urgent needs. Administrative authorities still have great discretion to draft laws and regulations without offering a rationale or publishing their opinions. Foreign investors have complained about being treated less favorably than their domestic counterparts. But Chinese firms and citizens also suffer from the lack of systematic consultation procedures (see American Chamber of Commerce 2008; Greene and Tsai 2008).

5. Encouraging consultation between the public and private sectors

International practice shows that establishing consultation guidelines is essential, but not sufficient to change the administrative culture. Some countries with long history of democratic and open policy making processes, such as the Nordic countries, have encountered some fatigue in consultation even without guidelines. A challenge for countries with less open and transparent policy making processes is to embed consultation in the administrative culture of designing and promulgating regulations.

Example: Bangladesh

The Poverty Reduction Strategy of the Government of Bangladesh designates the improvement of the business climate as a core activity of any development effort. The International Financial Corporation supports these efforts through the Bangladesh Investment Climate Fund, providing a platform for improved cooperation between the private and the public sector. The private sector plays a key role by participating in different forums—in particular, the Bangladesh Better Business Forum—which address regulatory reform and the streamlining of administrative procedures. The goal is to enhance capacities in government to improve the quality of regulation.

The regulatory reform efforts concentrate on strengthening consultation mechanisms and evaluating the possibility of introducing an RIA system. Consultation guidelines have been prepared to be submitted to the government for adoption. RIA is still in the early stages, but it will benefit from a systematic consultation procedure. The consultation procedure is essential for the government to better understand the constraints faced by the private sector and for the latter to participate in the formulation of policies.

Conclusion

Consultation is certainly not the only tool to be used in a framework for regulatory reform, but it represents a major condition for success. Some emerging and developing countries, like many OECD countries, have embarked on broad government reforms to make the relationship between authorities and citizens more transparent, open, and efficient. It is essential that the role of consultation be strengthened to ensure the full benefits of all reform efforts. Experiences in OECD countries and in the developing world provide ample guidance to tailor solutions to the situation in a particular country and to improve the business environment in the pursuit of competitiveness.

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LOWERING TAXPAYER COMPLIANCE COSTS

by Mark Gallagher and Arturo Jacobs

It should not cost an arm and a leg just to pay your taxes

While debate continues about the impact of taxation on business incentives, there is almost complete agreement that the costs of complying with the tax system requirements can be quite high and can harm firms' ability to compete, create jobs, and foster economic growth and well-being. The U.S. Agency for International Development (USAID) economic growth strategy puts primary emphasis on the firm as the source of economic growth, subject to a number of enabling factors and conditions (USAID 2008). Harberger (2005) conditions incremental economic growth firmly on the ability of enterprises to reduce their "real costs"—what he calls Real Cost Reduction (RCR). Comparing a variety of countries under different scenarios, Harberger concludes that RCR generally has made a greater contribution to economic growth than have increments in either labor or capital. In other words, reducing the real costs of enterprises has been more important to growth, in a wide variety of cases, than added labor or new investment. Lowering taxpayer compliance costs represents an RCR for enterprises and can therefore be an important component of any economic growth strategy.

These costs vary widely from country to country. One study in Croatia estimated corporate income tax compliance costs borne by firms to be equal to 11 percent of the amount of taxes actually paid. Das-Gupta (2003) found that compliance costs in India amounted to almost 15 percent of actual corporate tax revenues. In the United States, such costs have been pegged at more than 20 percent of total federal tax revenue (Hodge, Moody, and Warcholik 2006). For New Zealand, Turner and Oxley (2005) estimated that tax compliance costs amounted to about 22 percent of total firm turnover for small businesses, although the percentage declined sharply for larger enterprises.

The estimates for the United States and New Zealand did not include the value of the time required to deliver reports; to make monthly, quarterly, and annual payments to the tax administration; and to have these accepted, stamped, and validated. These queuing costs pose a major problem in places such as Bosnia and Herzegovina, Curaçao, Moldova, and Puerto Rico.

Another cost to small businesses in emerging market countries, including Georgia, Uzbekistan, and Indonesia, is the sense that they are being preyed upon by tax inspectors. Gallagher and Bosnic (2004) concluded that the tax inspection process in Bosnia and Herzegovina represents a real burden on small taxpayers, especially in terms of time and uncertainty. Gallagher et al. (2008) found similar problems with tax inspections in Moldova. In many countries of the world, taxpayers must obtain certifications from the tax department that they are up to date on their tax obligations to participate in such activities as duty-free importing or government procurement processes. Depending on how these certifications are done, this can be a very expensive process in terms of time and internal costs. Non-transparent procedures also create opportunities for corrupt practices by tax officials.[1]

[1] Generally, in the United States, taxpayers may be required to self certify that they are registered as taxpayers and are current with obligations or have entered into payment agreements with tax authorities.

In countries such as Guatemala and Indonesia, the law requires the tax administration to promptly audit all taxpayers' claims for refunds, regardless of amounts and of potential revenue loss to the government. And when tax administrations are ill equipped to meet this requirement, lengthy delays are the norm. Particularly for small taxpayers, these delays threaten cash flow and financial stability; for exporters, delays in value added tax (VAT) refunds weaken their competitiveness. Often, tax administrations simply have not yet taken advantage of advances in information technology that could both simplify taxpayers' compliance and facilitate tax administration activities. Using such methods could lower the costs and raise the efficiency of tax administration, while protecting revenues.

Tax administrations around the world are experimenting with new ways of treating their taxpayers—ways that aim to reduce the compliance costs taxpayers bear. This paper lays out some of the more fruitful reforms that have been implemented in recent years, drawing mainly on the authors' first-hand experience in a wide range of countries, especially Armenia, Bosnia and Herzegovina, Curacao, El Salvador, Georgia, Guatemala, Indonesia, Jamaica, Jordan, Moldova, Pakistan, Puerto Rico, and Uzbekistan.

Lower the frequency of tax payments or tax filing

Many countries require taxpayers to pay VAT, as well as corporate income tax and personal income tax withholdings, on a monthly basis. Sometimes it is even more frequent: in Sarajevo (Bosnia and Herzegovina), until 2005 taxpayers had to pay three different taxes weekly (on sales, beverages, and catering), in three separate payments. In some countries, withholding taxes on salaries are to be paid twice monthly.

Lowering the frequency for paying such taxes from monthly (or more often) to quarterly could result in considerable savings for both business and the tax administration. However, treasuries may see less frequent payments as threats to their cash management. One possible solution is to put different taxpayers on different schedules. It might make sense to have small taxpayers pay quarterly, while keeping larger taxpayers on more frequent schedules. For VAT payments, enterprises which regularly claim refunds could retain a monthly filing period, but small enterprises could be given two or three months, or even longer.

In the United Kingdom, for example, small enterprises file only one VAT declaration per year, although they pay one-twelfth of their estimated tax bill every month, with a reconciliation made at the end of the fiscal year. To ease the reporting burden on all taxpayers, Latvia introduced a one-page VAT declaration in 1998, as well as a shortened excise tax declaration on alcoholic drinks (two pages); beer (one page); tobacco (one page); and oil products (two pages).

Do not tax people who have little money

In Moldova, the personal income tax applies to all workers, regardless of income. An analysis of the personal income tax (Gallagher 2008) shows that the poorest 47 percent of workers contribute only 3 percent of personal income tax revenue. By raising the personal deduction, 47 percent of the current taxpayers would be removed from the system, yet the government would lose only a very small amount of revenue. Since most of these persons are legally entitled to tax refunds, the loss would be even less.

In Croatia, the Croatian Employers Association proposed a "flattening" of the personal income tax, which includes tripling the personal deduction, eliminating most other deductions, and broadening the tax base to include taxes on property and capital income. This proposal would result in maintaining revenues, while reducing the number of individuals on the tax rolls by more than a third.

Reducing the number of persons subject to the personal income tax, while maintaining revenues, is win-win-win. Poorer persons find their tax burden lifted. Businesses find their tax reporting requirement lightened. And tax administrations can reduce their data entry, record maintenance, audit, and many other work requirements.

Raise the VAT threshold to exclude smaller businesses

A simplified structure for VAT, such as eliminating all but the single tax rate, would also save businesses money. A study in Sweden showed that compliance costs increased for all business by about 25 percent with each additional VAT rate. A single VAT rate would therefore yield substantial savings.

For small business, a major option is to exempt them from the VAT altogether. Studies have shown that the vast majority of firms can be excluded from VAT requirements at a minimal loss of revenue for the state. Ebrill et al. (2001) found that the average threshold for VAT registration around the world was about $90,000 in annual revenue (all dollar amounts are in U.S. dollars). This number varies widely, of course. For instance, at the time, the VAT threshold in Singapore was $700,000. In contrast, the VAT regime in Moldova requires registration and filing for all businesses with at least $30,000 in annual receipts.

In January 2009, the VAT threshold in Armenia was increased from 0 to $194,000. This should substantially reduce filing and recordkeeping costs for small and medium-sized businesses, as well as for the tax administration.

Simplify income taxes and accounting requirements for small business

In Bosnia and Herzegovina, starting in 2006–2007, businesses not exceeding a certain size have the option to simply pay tax at a reduced rate on their total revenues, rather than on their profits. Businesses choosing this option would merely need to account for their total receipts on a monthly basis. They would not need to maintain complete business accounts, account for losses and gains in capital values, depreciate their assets, or write off bad debts or create reserves. The applicable rate is about one-third of the corporate income tax rate. While not all small businesses will necessarily choose this option, it is available and can greatly simplify their tax recordkeeping requirements.

In Tanzania, a similar tax on gross company receipts is also available, but it is progressive. That is to say, the rate applied increases, much as a progressive personal income tax schedule does, with the amount of gross income. The Tanzania model might be preferred over the Bosnian model only if it is clear that profit margins rise with size or volume.

Use pre-filled tax declarations

Tax administrations in some Organisation for Economic Co-operation and Development (OECD) countries have recently begun to use data already available to them to pre-fill taxpayers' personal income tax declarations. They then send them to the taxpayer, who can accept them by signing and returning the form. The taxpayer can submit an alternative declaration if there is information in the pre-filled out form that the taxpayer considers incorrect or incomplete. The pre-filled personal income tax method started in the 1980s in Denmark, and then moved to all of the Nordic countries. By 2008, Australia, Belgium, Chile, France, Portugal, and Spain had moved to the pre-filled personal income tax forms, and the Netherlands plans to introduce it in 2009.

Generally, the pre-filled form is only used for personal income taxation, requiring access to third-party information from banks, employers, and businesses that employ independent contractors to perform specific work. The availability of such information is of course a prerequisite.

Facilitate e-filing and e-paying

Several countries have enabled taxpayers to file their declarations electronically. These e-declaration systems reduce requirements for taxpayers to print and store documents, and do away with the need to snail-mail or hand-deliver these documents. Many OECD countries have employed this option for more than a decade. Moldova is currently developing an e-declaration filing system, and the State Revenue Committee of Armenia is also investigating e-declarations.

Some systems also offer taxpayers the additional option of paying their taxes electronically. In these countries, such as Guatemala and Brazil, taxpayers can download free software designed by the tax department for filing tax declarations and making payments. Interactions are password-protected. Taxpayers also have the option of paying their taxes through a direct bank wire transfer or with a credit card.

Tax administrations also benefit from electronic filing and paying. Under traditional paper filing and paying, tax administrations must re-enter much of the data the taxpayer has included in the tax declaration or payment documents. In addition to the resources required, errors often creep into the database. Such errors often create considerable extra work for both the tax administration and the taxpayer.

Introduce bar codes

Most countries, however, will require changes in their laws, both those governing tax administration and those that establish or regulate the use of electronic signatures and e-governance, to take advantage of the above options. Legal, institutional, and administrative obstacles may hamper or prevent a move to e-filing at least for some time. Moldova, for example, requires taxpayers to sign each page of the tax declaration, which makes e-filing all but impossible. Potential solutions include the system used in the U.S. state of Virginia, where a common piece of software can produce hard copies of the tax declaration, with all the information on bar code, allowing the taxpayer to mail the tax form, signed, with a bar code at the bottom of the page.

The bar code solution also reduces data entry requirements for the tax administration. The taxpayer in turn can now use web-accessible forms that produce the final declaration with the bar code at the bottom. If the document could be transmitted electronically, say in .pdf format, the taxpayer could sign the file electronically, and would not be required to physically deliver the declaration to the tax administration.

Establish one-stop revenue service centers

Voluntary compliance with tax laws creates more tax revenue and lowers the cost of enforcement. In an effort to encourage voluntary compliance, some tax administrations have found various ways to treat taxpayers like valued customers.

For example, Jamaica established two one-stop tax service centers a few years ago. These now issue taxpayer identification numbers and tax compliance certificates, collect stamp duty and transfer taxes, and receive tax returns and payments. One of the centers also maintains the central motor-vehicle registry. Most transactions can be handled in a single visit by the taxpayers.

These taxpayer service centers in Jamaica—and in several other countries—are also equipped with electronic numbering systems (“QMatic Systems”), and taxpayers are provided chairs to await their automatic, numbered turns in getting needed services. Such efforts go a long way toward making taxpayers feel like real customers. World Bank consultants recently proposed a one-stop revenue service center for Tanzania to replace the current system, which required multiple visits to different agencies.

The one-stop tax service center concept can be broadened to a "whole of government" facility. For instance, in many countries, government agencies require businesses to file regular reports about their finances, their employment, output, and other economic information. Often, the same information is required by various agencies, requiring multiple reporting of the same information. In 2007, the Netherlands launched a comprehensive reform of its reporting system. A standard taxonomy for tax, finance, and other economic statistics has already been developed, along with a consistent methodology. The Dutch authorities estimate that businesses will be able to reduce their total government reporting requirements by about one-third.

Contract out the tax receipts business

Guatemala and El Salvador, among other countries, have negotiated contracts with commercial banks and developed software that is given free to the banks for processing tax payments. Under this arrangement, commercial banks receive and process tax declarations together with payments, and provide taxpayers with receipts for tax declarations and payments received.

Contracting out the tax receipts business, however, raises a confidentiality issue. Guarding the confidentiality of taxpayer's financial information on tax returns is of paramount concern. In the United States, contracts with commercial banks involve only deposit of tax returns in sealed envelopes into locked boxes on banks' premises for daily forwarding to the tax administration. In other countries (such as Guatemala, Chile, and El Salvador), the confidentiality issue is handled in contracts with banks that include penalty clauses for unauthorized disclosure of taxpayer information.

Integrate reporting and paying

Many tax administrations require taxpayers to file and pay each specific tax separately. In two countries, Australia and Sweden, taxpayers are now able to combine their reporting and payment of multiple taxes in a single transaction. Combining payments in this fashion does not represent a great administrative change for tax administrations, but it will require some adjustments in the tax accounting processes they operate, as well as restructured forms.

Ensure clearer tax legislation

In Armenia, taxpayers complain about the poor quality of tax law language, which leads to ambiguity and leaves the system open to multiple and contradictory interpretations. For instance, the second paragraph of Article 22 of the Law on Taxes is a single sentence with more than 230 words. This article specifies general tax compliance obligations of taxpayers as well as requirements for tax officials. Improved legal drafting would go far toward clarifying these important obligations.

Moldova, like several other countries of the former Soviet Union, has developed a single, coherent, and comprehensive tax code. This tax code includes substantive legislation as well as tax administration and compliance requirements. It is well written and easily accessed on the website of the State Fiscal Service. The Government of Jordan has developed a similar comprehensive tax code, which, at this writing, is before its economic cabinet for consideration and prior to submission to the Parliament.

Clear, comprehensive tax legislation is essential to the fair application of tax regulations and should be encouraged in all countries.

Simplify taxpayer compliance certifications

Many countries, especially in Latin America and in Central and Eastern Europe, require tax certifications for opening bank accounts, participating in public tenders, or taking advantage of certain programs, such as certain import duty reductions. This certification confirms that the taxpayer is indeed current with his or her tax obligations.

It sounds straightforward, but problems abound. Tax administrations in many countries may not have comprehensive, accurate, or easily accessible taxpayer current accounts, and often administrators simply do not believe that they can rely on them. Sometimes taxpayer databases are maintained on regional or local levels, and central access may be difficult. In Kyrgyzstan, for example, only a few years ago master files were established and maintained at 64 rayon (district) offices, but there was no central database for the entire country. Similarly, taxpayers are segmented into 41 different tax regions in Moldova, and the need to get information locally for national-level taxpayer compliance certification is a hurdle that continues to take more time than it should.

Comprehensive and reliable current accounts may not guarantee smoother taxpayer certifications. In the Republic of Srpska, a subnational entity of Bosnia and Herzegovina, USAID's Tax Modernization Project assisted in creating a fully operational, web-accessible, accurate, and complete taxpayer current account system. But then the tax authorities decided that taxpayers requesting certifications would have to meet all *upcoming* obligations through the end of the current quarter. The decision delayed the issuance of certificates. Worse, taxpayers were now forced to make tax payments two or three months in advance, imposing a significant financial burden.

In El Salvador, the current-account system was incomplete, fell out of date, and contained arithmetical errors. Many taxpayers were erroneously listed as noncompliant, even though they were current. Taxpayers were forced to correct errors or slight discrepancies before a certification would be issued. Bribes were often required to get a certification more quickly—or at all.

The practice of requiring taxpayer compliance certifications is widespread, and on the face of it appears to be a reasonable way of ensuring compliance, reducing fraud, and generating revenues. However, we have found little evidence that it works as advertised. Our recommendation is that instead of trying to streamline the process, authorities should instead simply abandon this requirement altogether.

Consolidate taxes

Reporting and other compliance costs can be reduced by replacing multiple taxes on a single base with a single tax. For instance, in Bosnia and Herzegovina, a multitude of taxes on specific forms of personal income imposed at the cantonal (regional) level have been replaced by a single personal income tax imposed on the entire "entity." The new tax replaces about 70 different cantonal taxes, and the revenue is shared with the cantons. In addition, four or five (depending on locality) different taxes on real property use have been replaced by a single, comprehensive tax on real estate.

Conduct better and fewer audits

In some countries, the tax administration attempts to carry out annual (or more frequent) audits for a large number of taxpayers. Frequently, these audits yield little additional revenue for the state, yet they entail considerable bother for the taxpayer. In these countries, taxpayers often complain that the tax staff are ill informed, aggressive, and look to harass taxpayers unduly. In Indonesia in 2000, some 5,323 mandatory audits of refund or credit claims yielded an average of only 27,000 rupiah each—less than $3 at the time. In contrast, 6,632 regular, comprehensive audits of returns selected because they showed some elements of risk yielded an average of 9 million rupiah each, or $800 at the time.

Various options are available for enhancing the audit process in a way that will improve compliance while reducing the burden of the tax system on law-abiding taxpayers:

- Develop and use risk-based audit selection systems.
- Establish and adhere to policies that prohibit "repeat audits." In the United States, the Internal Revenue Service adheres to a policy

whereby taxpayers (except the largest taxpayers in the country) will not be audited for income tax more than once every three years, unless results of a prior audit suggest risk.

- Establish systems and policies for better selection of taxpayers to be audited, to sharply reduce the number of audits.[2]
- Train auditors, and create specialists where specialization may make sense. For instance, countries may need specialists in specific industry sectors, such as petroleum extraction, minerals mining, international operations, and the financial sector.

In Pakistan, taxpayer profiles and audit parameters were carefully developed and established electronically to produce a risk score on every sales tax refund claim to flag suspect claims based on various data elements. The suspected refunds are placed in a “red channel” for manual audits. Refunds not flagged for audit—a very large majority of cases—are processed through the “green channel” immediately, and the average refund processing time has been reduced from 6–10 months to about 10 days.

The Income and Sales Tax Department of Jordan is quite happy with the progress it has been making in better selecting taxpayers for audit. However, even with all Jordan’s work so far assessing risks and building information systems, nearly half of the country’s companies are still subject to annual audit. Clearly, more needs to be done to reduce the number of audits and to deepen the audits that are carried out.

Some final remarks

Tax administrations around the world are constantly modernizing, experimenting with new ways of doing their business, meeting their objectives, and reducing unnecessary compliance costs on taxpayers. These tax administrations need mechanisms for sharing these experiences and learning from each other’s successes and failures. Perhaps the best forum for this is the OECD. The problem, however, is that the OECD only covers the more industrialized countries. Not all OECD country experiences can be easily adopted or adapted to developing country situations. The International Monetary Fund publishes many papers on taxation around the world, but these are almost exclusively focused on tax policy and pay very little attention to tax administration.

As a group, international tax administration advisors are an important source of knowledge on these innovations. But these people do not generally produce papers, nor are they given incentives to do so. Some technical assistance programs in tax modernization, such as those funded by USAID or by the European Union, have included observational travel to other countries. Such travel programs are valuable and have spurred change in a number of instances, but they are very expensive and reach few people.

Regional tax administration organizations, such as the Inter-American Center of Tax Administrations, headquartered in Panama, or the Intra-European Organization of Tax Administrations, headquartered in Bulgaria, do attempt to share innovative experiences. But these are limited to regional exchanges of information, and the presentations are rather ad hoc. In addition, some of the regional tax administration associations restrict access to such information to persons who are officials in the member organizations.

A decade ago, Tanzi (1999) proposed a World Tax Organization. Such an organization, in Tanzi’s vision, would have some real authority with respect to setting standards for taxation around the world. These standards would relate to types of taxation, economic treatment of taxation, and even tax administration. Another reasonable role for this World Tax Organization would be to monitor and report on tax administration innovations, such as those treated in this paper, as they happen around the world.

[2] For instance, in the United States, where voluntary compliance is relatively high, less than 1 percent of companies are audited in a year.

Alas, after more than 10 years of talk on the topic, no World Tax Organization has yet come on the horizon. In the absence of such a group, USAID's Fiscal Reform and Economic Governance program has set up a webpage on its website (www.fiscalreform.net) to serve as a repository of useful knowledge about tax innovations around the world, similar to those discussed briefly in this paper. If you have a story to tell, and can tell it in one page, please send your contribution to us at innovations@dai.com for possible publication on our website. Watch our website for specifications for these submissions—and for new examples of better approaches to taxation.

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AUTHORS

David Anderson leads the Indonesia Agribusiness Market and Support Activity (AMARTA), a program funded by the U.S. Agency for International Development (USAID). Formerly a senior executive with Del Monte, Chiquita, and other leading agribusinesses, Mr. Anderson has led agricultural planning, production, research, and marketing efforts in 11 countries.

Dan Charette is an enterprise development specialist at DAI, where he applies the principles and tools of value chain development, business environment reform, and public-private partnerships to DAI projects. For example, in 2008, he managed an International Labour Organization-funded assessment of regulatory barriers faced by the handloom weaving value chain in Ethiopia.

Ulrich Ernst is an expert in structural reform, competitiveness, macroeconomic policy, economic and financial modeling, and privatization. Dr. Ernst is both a thought leader—he has served as technical editor for various issues of *Developing Alternatives*—and an experienced development practitioner, having worked in developing countries worldwide.

Denis Gallagher manages the Regulatory Reform Initiative for USAID's Technical Assistance for Policy Reform II project in Egypt. He has served as an economic policy and regulatory reform expert with DAI since the late 1990s, including as Country Director of BIZPRO/Moldova and as Senior Policy Advisor for the Market Access Program in Palestine.

Mark Gallagher has been a catalyst for fiscal reform in transition economies and politically challenging environments for more than two decades. He has served as an economist with both USAID and the World Bank, and has been an advisor on fiscal reform and economic governance in two dozen countries. Dr. Gallagher leads USAID's worldwide Fiscal Reform and Economic Governance program.

Lara Goldmark leads USAID's Improving the Business Climate in Morocco program. A private sector development economist with experience in small enterprise development, microfinance, and regulatory and legal reform, she was formerly with the Inter-American Development Bank.

Arturo Jacobs has 40 years of experience in tax administration. He has served as a senior advisor to the World Bank and has participated in 25 projects financed by the World Bank, USAID, and other donors. His 33-year career with the U.S. Internal Revenue Service included 11 years as Director of the Houston, Texas, District. His publications on tax administration include a study to establish anti-fraud and anti-corruption units in Guatemala and benchmarking studies in Guatemala and El Salvador.

Jeffrey S. Lubbers is a Fellow in Law and Government at American University's Washington College of Law where, since 1996, he has taught administrative law and related courses. He served previously with the Administrative Conference of the United States. He is the author of the American Bar Association's (ABA) *Guide to Federal Agency Rulemaking* and editor for the ABA's *Developments in Administrative Law and Regulatory Practice* (volumes from 1998–2008).

Edmund Malesky teaches at the University of California's Graduate School of International Relations and Pacific Studies. He is the lead author for USAID's Vietnam Provincial Competitiveness Index and the Cambodian Provincial Environment Scorecard for the World Bank and The Asia Foundation. Professor Malesky has published in journals including the *Journal of Politics*, the *Quarterly Journal of Political Science*, and the *Journal of Law, Economics, and Organization*.

Bryanna Millis specializes in competitiveness and business environment reform. She has worked in numerous countries and currently supports business environment reform programs in Morocco and Moldova. Before joining DAI, Ms. Millis worked as a quantitative economist at the Global Development and Environment Institute at Tufts University.

Steve Parker is DAI's lead economics and trade advisor. His previous roles include serving as DAI's Chief of Party for the USAID-funded Support for Trade Acceleration and Reform (STAR) project in Vietnam; as Senior Research Fellow at the Asian Development Bank Institute; as Chief Economist for The Asia Foundation; as Trade and Macroeconomist for USAID in Indonesia; and as the lead trade and development economist for the Congressional Budget Office.

Delia Rodrigo is a regulatory reform expert at the World Bank's Corporate Investment Climate Department, where she works on regulatory governance, licensing reform, and administrative simplification issues. Dr. Rodrigo leads the Better Regulation for Growth Program focused on adapting regulatory reform concepts and tools for developing countries.

Pantjar Simatupang is a senior researcher and a former director of the Center for Agro Socio-Economic and Policy Analysis at the Indonesian Ministry of Agriculture. Dr. Simatupang has extensive research experience in agricultural issues, and currently serves as AMARTA's agricultural economics advisor.

Helle Weeke manages DAI projects in fiscal reform, business environment reform, trade and investment, and labor standards. She served as Chief of Party of the Vietnam Competitiveness Initiative and as Senior Legal Advisor for the STAR projects from 2002 to 2007. Before joining DAI, she practiced international trade law and commercial litigation.

DAI

7600 Wisconsin Avenue
Suite 200
Bethesda, Maryland 20814 USA

DAI Advancing Human Prosperity